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**CHAPTER 2****2-000 Auditing Standards****2-001 Scope of Chapter**

This chapter discusses the auditing standards that apply to DCAA audits. Auditing standards differ from audit procedures in that procedures relate to acts to be performed, whereas standards deal with measures of the quality of the performance of those acts and the objectives to be attained by use of the procedures.

**2-100 Section 1 --- Auditing Standards and DCAA Audits****2-101 Generally Accepted Government Auditing Standards (GAGAS)**

a. By reference, DoD Instruction 7600.2, "Audit Policies," dated April 27, 2007, incorporates Government Auditing Standards (commonly referred to as the "Yellow Book" and developed and published by the Comptroller General), and guidance issued by the Council of Inspectors General on Integrity and Efficiency and the DoDIG. These standards are applicable to DCAA.

b. The Yellow Book, alternately referred to as generally accepted government auditing standards (GAGAS), incorporates certain standards of the American Institute of Certified Public Accountants (AICPA). When the Yellow Book incorporates standards of other authoritative bodies, such as the AICPA or the Office of Management and Budget, those standards become GAGAS.

c. A major revision of the Yellow Book, which supersedes the 2003 revision, was issued in July 2007. A copy is included in each DCAA FAO library, and is available on the DCAA Intranet under Useful Audit Links or at the GAO web site, <http://www.gao.gov/govaud/ybk01.htm>. This is the fifth revision of the overall standards since they were first issued in 1972. The July 2007 Yellow Book includes changes to the standards in the following areas:

- Stressed the critical role of professional judgment in all aspects of GAGAS audits, in considering risk, and in complying with GAGAS overall;
- Expanded the description of competence to emphasize its importance and relate it to key steps in performing an audit and reporting the findings and conclusions;
- Heightened emphasis on ethical principles as the foundation, discipline, and structure behind the implementation of the standards;
- Adopted new definitions related to reporting internal control deficiencies as material weaknesses;
- Clarified and streamlined the discussion of nonaudit services and their impact on auditor independence.

The revised standards are applicable for financial audits and attestation engagements for periods ending on or after January 1, 2008, and for performance audits beginning on or after January 1, 2008.

d. All audits begin with objectives, and those objectives determine the type of work to be performed and the auditing standards to be followed. The types of work that are covered by GAGAS are classified as financial audits, attestation engagements, or performance audits. The majority of the work performed by DCAA falls under the attestation engagement classification. The general, field work and reporting standards for attestation engagements are in Chapter 6 of the Yellow Book (see 2-300 and 2-400 for a discussion of the field work and reporting standards, respectively). In addition, DCAA may perform economy and efficiency audits (operations audits) that fall under the performance audit classification. The field work and reporting standards for performance audits are in Chapters 7 and 8 of the Yellow Book (see 2-500 and 2-600). The GAGAS general standards (Yellow Book Chapter 3) apply to all types of GAGAS engagements (see 2-200).

e. Fieldwork and reporting requirements for attestation engagements and performance audits are implemented through CAM guidance, supplemented by the Audit Planning and Performance System (APPS), standard audit programs and internal control matrices, and standard audit report paragraphs appearing in 10-200 (general), the balance of Chapter 10 (reports on specific types of audits), and in the audit report shells delivered by APPS and on the DCAA Intranet.

### **2-102 AICPA Attestation Standards**

a. For attestation engagements, the Yellow Book incorporates the AICPA's general standard on criteria, and the field work and reporting standards and related Statements on Standards for Attestation Engagements (SSAEs) unless specifically excluded or modified by GAGAS. Currently none of the field work and reporting standards and related SSAEs are excluded from GAGAS. The AICPA attestation standards that are incorporated into GAGAS deal with suitable and available criteria, adequate planning and supervision, sufficient evidence, and appropriate reporting (see 2-200, 2-300 and 2-400). A copy of the codification of the SSAEs is in each DCAA field audit office library.

b. An attestation engagement is defined in the Yellow Book and the SSAEs as one in which an auditor is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on a subject matter, or an assertion about the subject matter, that is the responsibility of another party. In reporting on an attestation engagement, it is important to identify the assertion or subject matter being reported on. In some instances, the auditor will report on an assertion, which may be certified (e.g., incurred cost proposal), or explicit (e.g., price proposals, certified or not). In other instances, the auditor will report directly on a subject matter (e.g., an audit of a contractor's business systems).

#### **2-102.1 Types of Attestations**

The attestation standards define three types of attestation engagements providing different levels of assurance in relation to the auditor's opinion or conclusions as reflected in the table below.

Type of Attestations	Type of Assurance	Type of Report Statement
Examination	Positive	Unqualified, Qualified, Adverse, or Disclaimer of Opinion
Review	Negative	Disclaimer of Opinion
Agreed-Upon Procedures	None	Disclaimer of Opinion

a. An examination consists of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter or assertion is based on or in conformity with the criteria in all material respects. An examination report provides a high level of assurance and the auditor’s conclusion is expressed in the form of an opinion (stated as positive assurance). Therefore, the audit objective is to gather sufficient evidence to restrict attestation risk to a level that is, in the auditor’s professional judgment, appropriately low for the high level of assurance that is imparted by the audit opinion. In such an engagement, the auditor should select a combination of procedures to assess inherent and control risk and restrict detection risk such that attestation risk is restricted to an appropriately low level. In the contract audit environment, evaluations of complete submissions (price proposals, claims, and overhead rate proposals), where the auditor establishes the scope, are performed as “examinations.” Additionally, the auditor may examine sufficient evidence to support an opinion for the audit of “parts of a proposal” while disclaiming an overall opinion on the proposal taken as a whole (see 10-305).

b. A "review" consists of sufficient testing to express a conclusion about whether any information came to the auditors’ attention based on the work performed that indicates that the subject matter or assertion is not based on or in conformity with the criteria in all material respects. The auditor accumulates sufficient evidence to restrict attestation risk to a moderate level and the work performed is substantially less than an examination. Therefore, the auditor would disclaim an opinion, and instead the conclusion is expressed in the form of negative assurance. Procedures performed are generally limited to inquiries and analytical procedures, rather than including search and verification procedures. Under GAGAS and the SSAEs auditors are precluded from performing a review in certain cases, e.g. if the report expresses an opinion on internal controls or compliance with laws and regulations. Because DCAA generally does not perform “reviews,” i.e., give negative assurance, such engagements are not discussed further in this chapter.

c. In an agreed-upon procedure engagement, an auditor is asked by the requestor to report on findings based on specific procedures performed on a subject matter or an assertion. The requestor and auditor must agree on the procedures to be performed and the criteria to be used. The procedures must be specific and include objective criteria. Auditors should not agree to perform procedures that are subjective and/or that would call for an opinion or opinion-like findings (see 14-1000). An agreed-upon procedures (AUP) report does not provide positive or negative assurance, and the report must disclaim an opinion. The AUP report should state the specific procedures performed and specific findings that should not be expressed in terms of questioned costs or recommendations. In addition, the standards require that all findings be reported unless materiality thresholds have been established by the requestor (see 10-1000).

### **2-102.2 Types of Report Statements - Unqualified, Qualified, Adverse Opinion and Disclaimer of Opinion**

a. When an examination discloses that the assertion is both complete and accurate and the auditor followed all applicable GAGAS requirements, the report opinion will be unqualified and give positive assurance.

b. When an examination discloses that the assertion is not in conformity with the criteria (i.e., the auditor has reservations about the assertion (see 2-402.3), e.g., it is incomplete or inaccurate), the auditor must issue either a qualified or adverse opinion, depending on the materiality of the departure from the criteria (e.g., considering the nature and significance of the audit exception(s)).

c. If the auditor did not comply with all applicable GAGAS requirements (i.e., the auditor has reservations about the engagement (see 2-402.3), e.g., the auditor was not able to perform all the procedures that he or she considers necessary in the circumstances) the auditor must issue either a qualified opinion or disclaim an opinion, depending on the significance of the potential effects of the departure from the requirements.

d. A qualified opinion indicates that, except for the effects of the matter to which the qualification relates, the subject matter or the assertion is in compliance with the established criteria (e.g., FAR/DFARS). A qualified opinion is expressed when:

(1) the auditor has significant reservations about the engagement; i.e., there is a lack of sufficient evidence, restrictions on the scope of the examination, or other departure from GAGAS that have led the auditor to conclude he or she cannot express an unqualified opinion and the auditor has concluded, based on the nature and magnitude of the potential effects of the issues and their significance to the subject matter or assertion, not to disclaim an opinion; and/or

(2) the auditor has significant reservations about the subject matter or assertion; i.e., the auditor believes, based on the audit, the subject matter under audit contains a departure from the established criteria, and based on the materiality of the departure, the auditor has concluded not to express an adverse opinion.

e. An adverse opinion states that the subject matter is not in conformity with the criteria, including the adequacy of the disclosure of material matters. In determining whether to express an adverse opinion rather than a qualified opinion, the auditor must consider the materiality of the departures from the criteria, keeping in mind that lower materiality levels are generally appropriate for GAGAS audits because of Government accountability and the visibility and sensitivity of Government programs (see 2-309). An adverse opinion is still an opinion and, therefore, should be expressed only when the auditor has performed an audit of sufficient scope.

f. A disclaimer of opinion is issued when there are scope restrictions and the departures from GAGAS requirements are so significant that the examination has not been performed in sufficient scope to enable the auditor to form an opinion. A scope restriction may be imposed by the contractor, the requestor, or by other circumstances such as the timing of the work or the inability to obtain sufficient evidence (see 10-210.4c).

g. When the auditor performs an application of agreed-upon procedures engagement (see 10-1000 and 14-1000), the resulting report must disclaim an opinion because the scope is limited to the procedures agreed upon by the specified parties. This is true even when the auditor has recommended the procedures to be applied and the requestor has

merely agreed that the proposed procedures will provide enough information for the requestor's purpose.

h. If, in the course of an examination, the auditor encounters a scope restriction, the engagement may not be converted to an application of agreed-upon procedures merely to avoid disclosing the scope restriction. However, under certain circumstances, an examination may, before the completion of the audit, be converted to an agreed-upon procedure engagement. A request to change to an agreed-upon procedure engagement may result from a change in circumstances affecting the requestor's requirements, or a misunderstanding about the nature of the original services or alternative services originally available. Before an auditor agrees to change to an agreed-upon procedure engagement, the auditor should consider:

(1) The possibility that certain procedures performed as part of an examination are not appropriate for inclusion in an agreed-upon procedures engagement.

(2) The reason given for the request.

(3) The additional effort required to complete the original engagement.

(4) If applicable, the reasons for changing from a general-use report (unlimited users) to a restricted-use report (limited to specified users) which is required under an agreed-upon procedures engagement.

### **2-102.3. Terminology**

The AICPA attempts to reserve the words "audit" and "auditor" to financial statement audits. The attestation standards convert the terminology "examination," "review," and "application of agreed-upon procedures" to verbs to describe the process that generates a report, and refer to auditors as "practitioners." The AICPA does not refer to an evaluation affording the highest level of assurance interchangeably as an "examination" or an "audit." DCAA will continue to use "audit" to describe, in general terms, the work performed. DCAA will use specific terminology in the reporting language for audits requiring different levels of assurance (i.e., an examination or an application of agreed-upon procedures).

### **2-103 Other Auditing Standards**

a. AICPA. In addition to its attestation standards, the Auditing Standards Board of the AICPA has also issued ten auditing standards, referred to as generally accepted auditing standards (GAAS), that generally apply to audits of financial statements. The AICPA, through its Auditing Standards Board, has also issued an extensive series of interpretations of GAAS (referred to as Statements on Auditing Standards (SAS)) which independent public accountants (IPAs) are expected to follow when performing financial audits of non-public companies. The SAS generally do not apply to the work DCAA performs (except for infrequent financial statement audits). However, DCAA guidance occasionally incorporates the principles and concepts of certain SAS. A codification of the SAS is in each DCAA field audit office library.

b. Public Company Accounting Oversight Board (PCAOB). The Sarbanes-Oxley Act (Public Law 107-204) gives the PCAOB the authority to set auditing standards to be used by registered public accounting firms in the audit of publicly traded companies. PCAOB auditing standards do not apply to DCAA.

## 2-104 Performance Audits

a. GAGAS define performance audits as engagements that provide assurance or conclusions on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audit objectives vary widely and include objectives related to assessing program effectiveness, economy and efficiency (operations audits); internal control; compliance; and prospective analyses (GAGAS 1.28).

b. The audit objectives of economy and efficiency audits (GAGAS 1.29) address the cost and resources used to achieve program results. DCAA operations audits are economy and efficiency audits. Examples of such audit objectives include:

(1) evaluating whether the entity is following sound procurement practices and obtaining resources at reasonable costs while meeting timeliness and quality considerations;

(2) determining whether and how costs can be decreased or productivity increased; and

(3) assessing whether the entity has complied with the laws and regulations concerning matters of economy and efficiency.

c. The other categories of performance audits are generally performed by oversight agencies such as the DoDIG and the GAO. For example, the objectives of an audit of program effectiveness and results address the value of a program and typically measure the extent to which a program is achieving its goals and objectives (GAGAS 1.29).

## 2-105 Nonaudit Services

Professional services provided by auditors other than audits and attestation engagements, referred to as nonaudit services, are not performed in accordance with GAGAS and must not be reported as such. GAGAS also require that an audit organization that perform nonaudit services for entities for which it also conducts GAGAS engagements, clarify that the scope of the work performed does not constitute an audit under GAGAS (GAGAS 1.33). Therefore, memorandums to the contracting officer on the results of nonaudit services performed by FAOs should include the following statement:

The scope of the work performed does not constitute an audit or attestation engagement under generally accepted auditing standards.

Nonaudit services are discussed in more detail in 2-203.4.

**2-200 Section 2 --- General Standards****2-201 Introduction**

This section explains the GAGAS general standards which apply to all types of GAGAS engagements. General standards relate to the competence of the staff, the independence of the audit organization and the individual auditor, the exercise of professional judgment in performing the audit and in preparing related reports, and quality controls and external peer reviews.

**2-202 Competence (GAGAS 3.40 – 3.49)**

a. This standard requires that those assigned to the audit collectively have the technical knowledge, skills, and experience necessary to be competent for the type of work being performed. Their qualifications should collectively be commensurate with the scope and complexities of the assignments and should include:

- Knowledge of GAGAS applicable to the type of work they are assigned and the education, skills, and experience to apply this knowledge to the work being performed;
- General knowledge of the environment in which the audited entity operates and the subject matter under review;
- Skills to communicate clearly and effectively, both orally and in writing; and
- Skills appropriate for the work being performed. For example, staff or specialist skills in:
  - (1) statistical sampling if the work involves use of statistical sampling;
  - (2) information technology if the work involves review of information systems;
  - (3) engineering if the work involves review of complex engineering data;
  - (4) specialized audit methodologies or analytical techniques, such as the use of complex survey instruments, actuarial-based estimates, or statistical analysis tests; and
  - (5) specialized knowledge in subject matters, such as scientific, medical, environmental, educational, or any other specialized subject matter, if the work calls for such expertise.

Audits vary in purpose and scope. Some require an opinion on the adequacy of financial representations; others an opinion on compliance with specific laws, contractual provisions, and other requirements; others require evaluations of efficiency and economy of operations; and still others require some or all of these elements. Since audits frequently require a wide variety of skills, an auditor may need technical assistance from other disciplines, such as legal, engineering, and production/quality control. The auditor should make arrangements to secure any needed technical assistance from the ACO/plant representative or responsible acquisition agency (see Appendix D).

b. The effectiveness of contract audits is governed in large measure by the caliber and training of the person or persons performing the work. The auditor is expected to have acquired through continuing education, training, and experience the ability to plan; develop and apply effective audit procedures; to determine facts; to make reasonable judgments and decisions; and to prepare objective and effective audit documentation and reports.

c. Competence is derived from a blending of education and experience. GAGAS 3.46 and DCAA require all audit staff members to complete 80 hours of professional training or development during each two-year reporting period. At least 24 of the 80 hours should be earned in subjects directly related to Government auditing or the Government environment. At least 20 of the 80 hours of training must be completed in each fiscal year. These hours of training are referred to as continuing professional education (CPE) credits. The terms “training” and “education” are used interchangeably. Additionally, auditors who use the work of external specialists should assess the professional qualifications of such specialists (see D-104 and D-105).

d. Continuing professional education is a shared responsibility of Headquarters and the regions; however, the primary responsibility resides with the individual supervisors and staff members. DCAA staff must have satisfied the CPE requirement to meet the Government Auditing Standards underlying audit planning, directing, conduct, and reporting. The specific responsibilities of all parties are defined in the DCAA Personnel Management Manual, DCAAM 1400.1.

e. These standards do not exclude the use of auditors in a training status, as long as trainees are assigned duties commensurate with their experience and capabilities and are adequately supervised. Proper supervision of the work done by trainees will contribute to their development and should assure maintenance of acceptable standards.

f. Auditors should be knowledgeable in the AICPA general attestation standard related to “criteria,” the AICPA attestation standards for field work and reporting, and the related Statements on Standards for Attestation Engagements (SSAE). They should also be competent in applying these standards and SSAEs to the task assigned.

## **2-203 GAGAS Independence**

a. In addition to complying with the Joint Ethics Regulations (DoD Directive 5500.7-R) demanded of all public servants, it is essential DCAA auditors comply with the prescribed GAGAS independence requirements. The GAGAS general standards emphasize that in all matters relating to the audit work, an individual auditor, and the audit organization, must be independent from the audited entity. The 2011 GAGAS revision established a conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence (refer to 2011 GAGAS for implementation dates). Although the 2007 GAGAS did not have this type of framework, the underlying independence concepts and principles in the 2007 GAGAS are included in the 2011 GAGAS conceptual framework for independence. Therefore, auditors should use the conceptual framework approach as a tool for evaluating independence issues when performing audits under the 2007 GAGAS( e.g. incurred cost audits for years prior to 2011 GAGAS implementation).

b. Auditors and audit organizations maintain independence to ensure their audit opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties. To comply with the independence standards, an auditor should avoid situations that could lead reasonable and informed third parties to conclude that the auditor is not independent and thus not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work. Each auditor has an obligation to refrain from entering into any relationship (financial, social, or other) with contractors and contractor

employees, that would impair his or her independence or objectivity or reflect discreditably on him/her, the Agency or DoD.

c. Auditors should be independent from the contractor during any period that falls within the period of the subject matter of the audit and during the period of the professional engagement. The engagement begins when the initial acknowledgement letter to the audit requestor or the audit notification letter to the cognizant government authority (e.g., ACO) is sent or when work is begun on the audit whichever is earlier. However, the period of professional engagement does not necessarily end with the issuance of a report and recommence with the beginning of the next audit. The period of professional engagement lasts the entire duration of the professional relationship, which for recurring audits could cover many periods.

### **2-203.1 Conceptual Framework Approach to Independence**

a. The conceptual framework assists auditors in maintaining both independence of mind and independence in appearance (Refer to GAGAS 3.02 for definitions of independence of mind and in appearance). It allows auditors to address threats to independence that result from activities that are not specifically prohibited by GAGAS. Auditors should apply the conceptual framework at the audit organization, audit, and individual auditor levels to (1) identify threats to independence; (2) evaluate the significance of the threats identified both individually and in the aggregate; and (3) apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

b. Threats to independence are circumstances that could impair independence. Threats do not necessarily impair independence. Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise the auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised. It will also depend on the specific safeguards applied to eliminate the threat or reduce it to an acceptable level. A wide range of relationships and circumstances may create threats to independence. Circumstances that result in threats to independence in one category may result in threats in other categories as well. The GAGAS conceptual framework approach to independence contains the following broad categories of threats to independence to use when identifying and evaluating threats.

(1) Self-interest threat - the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior;

(2) Self-review threat - the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit;

(3) Bias threat - the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective;

(4) Familiarity threat - the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship or that of an immediate or close family member, will lead an auditor to take a position that is not objective;

(5) Undue influence threat - the threat that external influences or pressures will impact an auditor's ability to make independent and objective judgments.

(6) Management participation threat - the threat that results from an auditor taking on the role of management or otherwise performing management functions on behalf of an entity undergoing an audit; and

(7) Structural threat - the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited will impact the audit organization's ability to perform work and report results objectively.

c. A threat to independence is not at an acceptable level if it either (1) could impact the auditor's ability to perform an audit without being affected by influences that compromise professional judgment or (2) could expose the auditor or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or a member of the audit team, had been compromised.

d. When an auditor identifies threats to independence of mind or in appearance and, based on an evaluation of those threats, determines the threats are not at an acceptable level, thereby requiring the application of safeguards, the auditor should determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce the threats to an acceptable level.

e. Safeguards are controls designed to eliminate or reduce to an acceptable level, threats to independence. Under the conceptual framework, the auditor applies safeguards that address the specific circumstances under which threats to independence exist. In some cases, multiple safeguards may be necessary to address a threat. GAGAS provides a list of safeguards that may be effective under certain circumstances. The list cannot provide safeguards for all circumstances, it may however, provide a starting point for auditors who have identified threats to independence and are considering what safeguards could eliminate or reduce the threat to an acceptable level. Examples of safeguards include:

(1) consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor;

(2) involving another audit organization to perform or reperform part of the audit;

(3) having a professional staff member who was not a member of the audit team review the work performed; and

(4) removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence.

f. Not all safeguards identified in GAGAS pertain to DCAA. For example, the safeguards included in GAGAS 3.19 relate to the audited entity's systems and procedures. Since DCAA performs audits for third parties, not the audited entity (contractor) these safeguards would not be applicable for DCAA.

### **2-203.2 Evaluation and Documentation of Independence Considerations**

a. Certain events require auditors to evaluate threats to independence such as the start of a new audit, assignment of new staff to an ongoing audit; and acceptance of a nonaudit service at an audited entity. However, many different facts and circumstances, or combination of facts and circumstances, can result in threats to independence or increase the significance of threats to independence. Auditors should use professional judgment to determine whether other events in addition to those stated above warrant evaluation using the conceptual framework.

b. Whenever relevant new information about a threat to independence comes to the attention of the auditor before, during or after the audit, the auditor should evaluate the significance of the threat in accordance with the conceptual framework and determine if the identified threat is at an acceptable level. If the threat is not at an acceptable level, the auditor should apply appropriate safeguards to eliminate or reduce the threat.

c. Certain conditions may lead to threats that are so significant that they cannot be eliminated or reduced to an acceptable level through the application of safeguards, resulting in impaired independence. Under such conditions, auditors should decline to perform a prospective audit, terminate an audit in progress, or inform report recipients of the impairment. Generally, this situation should not occur within DCAA because it is our policy that an auditor with an independence impairment will not work on affected assignments and we will not perform nonaudit services that impair independence.

d. GAGAS contains specific requirements for documentation related to independence that provides evidence of the auditor's judgments in forming conclusions regarding compliance with independence requirements. These documentation requirements include documenting identified threats to independence along with any safeguards applied to eliminate or reduce the threat to an acceptable level.

e. An audit organizations quality control system should establish policies and procedures to address independence. Such policies and procedures assist the audit organization to communicate its independence requirements to its staff, identify and evaluate circumstances and relationships that create threats to independence, and take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. Refer to 2-S103.1 for the policies and procedures on the documentation of independence considerations, and the actions to take when a threat to independence is identified before work is performed on an audit, during an audit and after report issuance.

### **2-203.3 Government Auditors and Audit Organization Structure**

The ability of audit organizations' in government entities to perform audit work and report the results objectively can be affected by their placement within the Government and the structure of the Government entity audited. DoD Directive 5105.36 (see Supplement 1-1S1) established DCAA as an independent agency of DoD; with the responsibility to perform all necessary contract audits for the Department of Defense. DCAA has been organizationally positioned within DoD to ensure independence from the various DoD departments and agencies involved in the acquisition process. In addition, DCAA performs audits of contractors, not other DoD entities accordingly, an environment exists where DCAA can function in an independent, objective manner in performing its contract audit services.

### **2-203.4 Independence Considerations When Performing Nonaudit Service**

a. GAGAS defines nonaudit services as professional services other than audits or attestation engagements. GAGAS does not cover nonaudit services; therefore, auditors do not report that the nonaudit services were conducted in accordance with GAGAS. However acceptance of a nonaudit service at an audited entity is an event that could create threats to independence in relation to audits, and should be evaluated using the conceptual framework approach to independence. If identified threats are significant, and the

application of safeguards would not eliminate or reduce the threat, the resulting impairment to independence could impair the independence of the entire Agency.

b. In cases where the audit organization was required by constitutional, statutory or regulatory requirements to perform a nonaudit service that created an impairment, GAGAS provides for the use of a modified GAGAS statement. However, it is DCAA's policy that auditors only perform nonaudit services that do not impair independence and do not require the application of safeguards. Therefore, a modified statement due to a lack of independence will generally not be used in DCAA audit reports. If an FAO believes a modified statement is necessary it should contact Headquarters PAS through its regional office.

c. DCAA provides nonaudit services to third parties such as the contracting officer and other procurement officials. DCAA does not perform nonaudit services for the audited entity; therefore the requirements for performing nonaudit services for the audited entity contained in GAGAS such as obtaining assurance the audited entity's management will oversee the service generally do not apply to DCAA nonaudit services.

d. DCAA defines the nonaudit services that it performs in the Activity Code Matrix and Activity Code Definitions in the DMIS User Guide. Auditors should perform nonaudit services only under one of the activity codes designated as such, and the services should fit within the parameters described in the DMIS definition for the particular activity code. Auditors should check the DMIS User Guide definitions when establishing an assignment to ensure that they are using the proper activity code for the audit or nonaudit service planned. The DMIS Activity Code Matrix and Definitions are available in the DMIS User Guide.

e. When the auditor cannot identify the requested services with any other activity codes, the auditor should use activity code 49800, Other Nonaudit Services. Effort under the 49800 activity code should be performed only after the FAO determines that providing the requested nonaudit service does not create a significant self-review threat or management participation threat to independence, either by itself or in the aggregate with other nonaudit services, with respect to current or future audits. The FAO should perform the assessment for independence threats using the GAGAS conceptual framework approach to independence. An independence assessment template, Other Nonaudit Services - Assessment of Threats to Independence, is available on the DCAA Intranet to assist FAOs in applying the conceptual framework when considering the performance of a nonaudit service under activity code 49800. The template includes the applicable references to the 2011 GAGAS standards. The FAO must coordinate the assessment with the Regional Office and Headquarters PAS before accepting the engagement to perform the nonaudit service. FAOs do not need to perform this assessment for nonaudit services performed under other DMIS activity codes designated as nonaudit services, as DCAA will maintain that documentation at the Agency level.

f. Since nonaudit services are not performed in accordance with GAGAS, any correspondence regarding such services should include a statement to that effect (see 2-105).

g. To avoid impairing independence or even the appearance of impairment, auditors will not participate as team members of Integrated Product Teams (IPT), which typically involve teaming with the contractor to develop a proposal. Auditors will also not participate in similar teaming arrangements or provide input to contractors on such items as draft proposals, draft policies and procedures, or draft CAS disclosure statements. Such

activities could result in significant self-review or management participation threats. However, auditors may provide general advice on what constitutes an adequate proposal (to include discussion of the proposal adequacy checklist in DFARS 252.215-7009) and explain the FAR 15.408 (Table 15-2) requirements for adequate cost or pricing data. Auditor participation in meetings held for these purposes do not impair independence. Auditors need to communicate with the contractor and the contracting officer during all phases of the audit. This is a requirement of the auditing standards and does not impair the auditor's independence. Refer to CAM 4-100 and CAM 4-300 for additional guidance on communication during the audit process. In addition, auditors must report significant deficiencies or other findings discovered during an audit even when the contractor takes corrective action during the audit.

h. FAOs should prepare and maintain documentation of nonaudit services performed. DCAA routinely performs some assignments as nonaudit services that have formal documentation packages generated by APPS that provide for sufficient documentation of the services (e.g., evaluation of final vouchers). However, when an FAO performs nonaudit services that do not have formal APPS packages, the FAO should prepare and maintain documentation with sufficient information on the nonaudit services to enable an experienced auditor with no previous connection to the assignment to understand the nature and scope of the work performed. Such documentation adds value as the work may be useful in future FAO activities (e.g., performing other nonaudit services or planning future work) and it allows internal and external reviewers to assess the services provided for compliance with GAGAS independence standards and DCAA policies and procedures. The form and content of the documentation will vary depending on the specific circumstances. In most cases, it should include the request (when applicable), the product provided (e.g., memorandum), and documentation of the nature and scope of the work performed unless it is evident in the product provided.

i. FAOs should file documentation for work performed under activity codes designated as nonaudit services in Livelink under the appropriate 800 series file codes based on the descriptions and guidance in DCAAM 5015.1, Files Maintenance and Disposition Manual. However, for documentation related to FLA services activities (30100, 30300, and 30550), activities related to investigative support, Form 2000 and Board of Contract Appeals cases (48600, 48610, and 49300), and the processing of public vouchers (41500), the applicable organizations should follow their current filing practices.

### **2-204 Professional Judgment (GAGAS 3.31 – 3.39)**

a. Auditors should use professional judgment in planning and performing audits and attestation engagements and in reporting the results. Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with applicable professional standards and ethical principals. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of evidence. Professional skepticism includes a mindset in which auditors assume neither that management is dishonest nor of unquestioned honesty. Believing that management is honest is not a reason to accept less than sufficient, appropriate evidence.

b. Using professional judgment in all aspects of carrying out professional responsibilities, including following the independence standards, maintaining objectivity and credibility, assigning competent audit staff to the assignment, defining

the scope of work, evaluating and reporting the results of the work, and maintaining appropriate quality control over the assignment process is essential to performing and reporting on an audit.

c. The matter of professional judgment concerns what the auditor does and how well he or she does it. For example, professional judgment in the matter of working papers requires that their content support the auditor's opinion. Auditors should use professional judgment in determining the type of audit to be performed and in establishing the scope, selecting the methods, and choosing tests and procedures for the audit. Exercising professional knowledge, skills, and experience to diligently perform in good faith and with integrity, the gathering of information and the objective evaluation of the sufficiency and appropriateness of evidence is a critical component of audits. The auditor must be fully aware of the purpose of the audit and be mentally alert, inquisitive, and responsible while performing the tests and procedures and in evaluating and reporting the audit results.

d. Professional judgment and competence are interrelated because judgments made are dependent upon the auditor's competence. Professional judgment represents the application of the collective knowledge, skills, and experiences of all the personnel involved in an assignment, as well the professional judgment of individual auditors. In addition to the personnel directly involved in the audit, professional judgment may involve collaboration with other stakeholders, outside experts, and management in the audit organization. For example, before beginning an audit of a proposal, the auditor should hold verbal discussions with the requestor to identify specific areas of concern or other relevant information they may have that could impact the risk.

e. Audit assignments and supervision should be commensurate with the auditor's level of knowledge, skill and ability. Final responsibility for audit quality rests with the audit team, who are expected to know the relevant accounting and auditing standards and to familiarize themselves with significant aspects of the contractor and submission being evaluated. Responsibility for assignment of audits to field auditors rests with the supervisor.

f. Considering the risk level of each assignment, including the risk that the auditor may come to an improper conclusion is another important issue. Within the context of audit risk, exercising professional judgment in determining the sufficiency and appropriateness of evidence to be used to support the findings and conclusions based on the audit objectives and any recommendations reported is an integral part of the audit process.

g. Auditors should document significant decisions affecting the audit objectives, scope, and methodology; findings; conclusions; and recommendations resulting from professional judgment.

h. GAGAS places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing audits. However, it does not imply unlimited responsibility or infallibility on the part of the individual auditor or audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with GAGAS may not detect a material misstatement or significant inaccuracy, whether from error or fraud, illegal acts, or violations of provisions of contracts or grant agreements. Professional judgment does not mean eliminating all possible limitations or weaknesses

associated with a specific audit, but rather identifying, considering, minimizing, mitigating, and explaining them.

i. Some contractor representations contain accounting estimates, the measurement of which is inherently uncertain and depends on the outcome of future events. The auditor exercises professional judgment in evaluating the reasonableness of accounting estimates based on information that could reasonably be expected to be available prior to a specified date, such as the contractor's certified cost or pricing data. The auditor often must rely on evidence that is persuasive rather than convincing.

### **2-205 Quality Control and Assurance (GAGAS 3.50 – 3.63)**

Each audit organization performing audits in accordance with GAGAS must establish a system of quality control designed to provide reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements and have an external peer review at least once every three years.

a. A strong, well-documented internal quality control system has been in place within DCAA since its inception. That system encompasses the Agency's leadership, and places emphasis on performing high quality work.

(1) Key elements of the system are described throughout this manual and summarized in 2-S10. The system is further documented in the Agency's charter, regulations, instructions, personnel management manual, etc. Agency managers and supervisors serve as focal points for assuring that policies and procedures are adequate (including an appropriate reflection of auditing standards) and are properly applied. The functioning strength of the Agency's system is apparent in the attention given to improving it over the years. In particular, the Agency's implementation of the Federal Managers' Financial Integrity Act and related DCAA internal management control system requirements (DCAA Regulation No. 5010.7) was achieved by consolidating the various existing quality controls. Procedures are in place for periodic vulnerability assessments and internal reviews.

(2) The Agency also documents its system of quality control for the DoDIG through completion of the form entitled (DCAA's) Audit Quality Control Policies and Procedures. The form is part of the Council of Inspectors General on Integrity & Efficiency (CIGIE) External Quality Control Review Guide.

b. Audit organizations performing audits in accordance with GAGAS must have an external peer review at least once every three years by reviewers independent of the organization being reviewed. The external peer review should be sufficient in scope to provide a reasonable basis for determining whether, for the period under review, the reviewed audit organization's system of quality control was suitably designed and whether the audit organization is complying with its quality control system to provide the audit organization with reasonable assurance of conforming with applicable professional standards. For DCAA, this function is performed primarily by the DoDIG.

### **2-206 Suitable Criteria (GAGAS 6.03)**

a. In addition to the general standards summarized above, for attestations, GAGAS incorporates the AICPA attestation general standard on criteria. The general standard related to criteria states that the auditor must have reason to believe that the subject matter

is capable of evaluation against criteria that are suitable and available to users. Criteria are suitable when they have each of the following attributes:

(1) Objectivity – Criteria are free from bias. To be free from bias, the criteria should be constructed so they do not color the subject matter in a way that leads to a predetermined result.

(2) Measurability – Criteria should permit reasonable, consistent measurements, qualitative or quantitative, of the subject matter. That is, measurable criteria provide results that would be substantially duplicated by different people using the same measurement methods.

(3) Completeness – Criteria should be sufficiently complete so that relevant factors that would alter a conclusion about subject matter are not omitted.

(4) Relevance – Criteria should be relevant to the subject matter.

b. The attestation standards require all four attributes to be present for the criteria to be considered suitable. Examples of suitable criteria routinely used by DCAA are FAR, DFARS and CAS.

**2-300 Section 3 --- Field Work Standards****2-301 Introduction**

The Generally Accepted Government Auditing Standards (GAGAS) for attestation engagements incorporate the AICPA field work standards and related Statements on Standards for Attestation Engagements (SSAE), unless specifically excluded or modified by GAGAS, and prescribe additional standards. This section explains how the GAGAS attestation field work standards are integrated with contract audit field work guidance.

**2-302 AICPA Field Work Standards****2-302.1 Adequate Planning (GAGAS 6.04a)**

The first AICPA field work standard states that the work must be adequately planned and properly supervised. Proper supervision is addressed in 2-302.2. Some of the additional GAGAS field work standards include specific requirements related to planning. Those specific requirements are covered in 2-303 and the following. This section addresses adequate planning in general.

a. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application. Planning an audit involves developing an overall strategy for the expected conduct and scope of the audit. To do this, the audit team needs sufficient knowledge to enable them to understand adequately events, transactions, and practices that, in their judgment, have a significant effect on the subject matter or assertion.

b. Factors to be considered in planning an audit include:

- (1) The criteria to be used;
- (2) Preliminary judgments about attestation risk and materiality,
- (3) The nature of the subject matter or the items within the assertion that are likely to require revision or adjustment,
- (4) Conditions that may require extension or modification of the audit procedures,
- (5) The nature of the report expected to be issued (e.g., examination report or agreed-upon procedures report).

c. Based on AT 601.32 (of the AICPA's Statements on Standards for Attestation Engagement (SSAEs)), Attestation risk is the risk that the auditor may unknowingly fail to modify appropriately his or her opinion when there is a material misstatement or noncompliance. It is composed of inherent risk, control risk, and detection risk.

(1) Inherent risk is the risk that a material misstatement or noncompliance could occur, assuming there are no related internal controls.

(2) Control risk is the risk that a material misstatement or noncompliance that could occur will not be prevented or detected on a timely basis by the contractor's internal controls.

(3) Detection risk is the risk that the auditor's procedures will lead him or her to conclude that a material misstatement or noncompliance does not exist when, in fact, such a misstatement or noncompliance does exist.

d. Before beginning an audit assignment, it is essential to coordinate with contracting officials requesting the audit or responsible for disposition of the findings and recommendations to understand the contracting officer/requestor's needs and/or specific

concerns; contractual, regulatory, or other factors pertinent to the evaluation; and to establish the type of report to be prepared upon completing the assignment.

e. The initial planning phase includes an evaluation of pertinent files, such as the working papers from previous audits, copies of contracts, and correspondence related to the current audit. It also includes discussion and coordination with contractor personnel, so that the work may proceed smoothly and efficiently. When appropriate, arrangements should be made for audits of costs of subcontractors or other divisions of the contractor and for technical assistance.

f. The audit team should consider the methods the contractor used to process accounting information in planning the audit because such methods influence the design of the accounting system and related internal controls (see 2-306). The nature and extent of audit procedures may be influenced by the extent to which information technology (IT) is used in significant applications, as well as the complexity of that technology.

g. GAGAS 3.42 requires that those assigned to the audit collectively have the technical knowledge, skills, and experience necessary to be competent for the type of work being performed. In some cases, this requires the use of specialists. Therefore, when planning the audit, the audit team should consider whether specialized skills are needed to achieve the objectives of the audit and make arrangements accordingly.

h. Before preparing audit programs, a risk assessment should be performed. A properly performed risk assessment should provide and consider information about risk factors relevant to the subject matter of audit; e.g., the size and scope of the contractor's activities or any areas in which there may be weaknesses in internal controls, uneconomical or inefficient operations, ineffectiveness in achieving prescribed goals, or lack of compliance with applicable laws and regulations that could have a material effect on the subject matter. In addition, auditors should consider indicators of unfavorable or adverse financial conditions or other circumstances which could impede a contractor's ability to perform on Government contracts. During performance of risk assessments, auditors are to contact the Contracting Officer to ascertain any known concerns that will impact the assessment of audit risk. In those situations where information regarding the contractor's financial condition is not available from the Contracting Officer, the auditor, at a minimum, should perform trend analysis of the contractor's key financial statement elements (i.e. profit/loss, sales, cash flow from operating activities, working capital) when documenting consideration of inherent risk (see 14-303e). If auditors are alerted to information that may indicate unfavorable or adverse financial conditions that could impede a contractor's ability to perform on Government contracts (e.g., recurring net losses, deteriorating sales, negative cash flow from operation activities, cash flow difficulties), they should immediately communicate those concerns/risk factors to the appropriate contracting officer and adjust the audit scope and associated audit procedures accordingly. Tests to determine the significance of the above risk factors are to be performed in the detailed audit work and should be carefully set out in the audit program. The risk assessment discussed here is primarily a review of prior audit work (e.g., permanent files, previous audit assignments, etc.). Understanding the contractor's internal controls and assessing control risk is an essential part of the risk assessment (see 2-306).

i. A written program should be prepared for each audit assignment to effectively communicate objectives to all staff members, to facilitate control of the audit work, and to provide a permanent record of the work to be accomplished. The Agency's electronic workpackages (audit planning and performance system; APPS) or standard audit programs

can be used to meet these objectives; or, if necessary, an existing set of audit steps can be used as a starting point for developing an audit program tailored to the specific evaluation being planned (see 3-203.3).

j. When multi-location programs are to be performed, the audit organization that is centrally planning the work should assure that assist auditors receive appropriate background information, including purpose, scope, level of evaluation (audit or agreed-upon procedures), and relevant documentation to assure that the resultant fieldwork can be assembled into a single report. However, this should be done in a manner that does not restrict the auditor's professional judgment. Audit programs should never be used as a blind checklist or in a way that stifles initiative, imagination, and thoroughness in performing an audit.

### **2-302.2 Proper Supervision (GAGAS 6.04a)**

Auditors must be properly supervised. Supervision is generally the responsibility of the supervisory auditor and FAO Manager and involves directing the efforts of subordinate staff members who participate in accomplishing the objectives of the audit and determining whether the objectives were accomplished.

a. Elements of supervision include instructing auditors, staying informed of significant problems encountered, reviewing the work performed, and dealing with differences of opinion among personnel. The extent of supervision appropriate on a given assignment depends on many factors, including the nature and complexity of the audit and the qualifications of the individual audit team members performing the work (i.e., the auditors' experience and competence). The supervisory auditor should inform the audit team of their responsibilities, including the objectives of the procedures for the particular segments of work assigned and matters that may affect the nature, extent, and timing of such procedures. The FAO manager should direct the audit team to bring to his or her attention significant questions raised during the audit so that their significance can be assessed.

b. The work performed should be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusion to be included in the report. The supervisory review must be completed and documented in the working papers prior to report issuance, and should include verification that:

- (1) the auditors conformed to the auditing standards,
- (2) the audit programs are followed, unless deviation is justified and authorized,
- (3) the working papers adequately support findings and conclusions (see 2-307 for the GAGAS on documentation),
- (4) the working papers provide adequate evidence to prepare a meaningful report, and
- (5) the audit team accomplished the audit objectives.

c. Supervision of individual audit assignments applies before, during, and after completion of the field work. Oral and written instructions, approval of the risk assessment and detailed audit programs, on-site guidance, and review of working papers and report drafts are all critical aspects of supervision. The depth and extent of supervision in individual cases will vary in relation to the materiality and complexity of the audit assignment and the competence and experience of the auditors assigned. The geographic location of the audit site should not limit or influence the amount of supervisory guidance and involvement. For example, supervision of a complex audit assignment which must be conducted on a TDY travel basis is usually not adequate if it

first begins with the review of working papers in the branch office after the field work is completed.

d. The various levels of supervisory responsibility discussed in the preceding and following paragraphs do not relieve each individual auditor of the responsibility for the professional adequacy of his/her own work. Similarly, the necessity for a detailed audit program prepared or approved at a higher supervisory level should not preclude any auditor from applying ingenuity during the course of the assignment to achieve the audit objectives and to recommend improvements of the program.

e. The auditor is primarily responsible for preparing and executing the audit program and for drafting the audit report. Thus, experience and grade level may differ depending on the complexity or sensitivity of the particular assignment, but must be adequate for satisfactory performance. He or she may act alone, or may be assisted by one or more auditors of the same or lower grade levels for part, or all, of the duration of the assignment. When the audit is conducted by a team, a lead auditor may, in addition to participating in the audit, monitor the day-to-day activities of all auditors assigned to assist and may review their working papers for both format and content.

f. The supervisory auditor plays a large role in the success of branch office operations. He or she has the fundamental responsibility of assuring that each team assignment is conducted in accordance with GAGAS, as well as the responsibility of participating in the overall planning and management of branch activities. The effectiveness of audit guidance and supervision depends in large part on his or her personal familiarity with the contractors assigned to the team. To carry out the responsibilities properly, the supervisory auditor must spend a considerable share of his or her time interacting and communicating with the field audit sites.

g. Many factors must be weighed in planning and scheduling supervisory visits. The supervisory auditor should visit each contractor having a continuing work-load at least once a year, but the timing and frequency of visits depend upon the materiality of the various audits in progress, the experience and proficiency of the auditors performing the assignment, and the type and significance of any audit problems encountered.

h. Before each field audit assignment is started, the supervisory auditor must ensure that the audit team understands clearly the purpose and scope of the audit, and any special matters which may be involved. He or she should ascertain that the auditors assigned have familiarized themselves with all relevant information available in the FAO permanent files (4-405). On recurring type audit assignments at active contractors, he or she should ascertain that an adequate audit program has been developed, with the purpose and scope of the audit, references, audit planning considerations, and preliminary, detailed and concluding steps tailored specifically for the assignment (3-203). In cases where the FAO does not have enough information about either the contractor or the assignment to develop an audit program in advance, the supervisory auditor should be sure that a general agenda has been prepared, sufficient to indicate the broad scope and approach planned, and that it will be supplemented with an audit program as soon as adequate background information has been obtained during the risk assessment. On all assignments, the supervisory auditor should also ensure that adequate arrangements have been made for any necessary external support, such as assist audits or technical assistance. This should preferably be done shortly after the request for audit was received.

i. While the audit is in process, the supervisory auditor should keep in contact with the auditor at the site, either through visits or by telephone or e-mail, frequently enough to:

- (1) give timely technical guidance on audit or accounting problems,
- (2) coordinate on any major changes the auditor proposes to make to the audit program or time budget,
- (3) perform interim reviews as warranted based on the complexity of the assignment (with any written review comments documented on APPS working paper A-2, Interim Guidance – Corrective Actions) and
- (4) maintain familiarity with the status of the audit.

These supervisory activities can generally be conducted more effectively by site visits than by telephone or e-mail.

j. After the conclusion of an assignment, the supervisory auditor will review the working papers and the report draft for compliance with GAGAS, professional quality, accuracy, and responsiveness to the audit request. The review should be in sufficient depth to evaluate the adequacy of significant technical judgments, findings, and recommendations made by the auditor. As well as making or suggesting any necessary changes to the report draft, the supervisory auditor should also prepare written review comments and include them in the working paper file (typically APPS working paper A-3, Final Review Comments). For contractors at which there is a recurring workload, the supervisory auditor may also include written observations or any recommended modifications to the audit program for subsequent audits.

k. Reviews of complex or sensitive audits should be conducted onsite if at all possible. In this way, any additional audit work or necessary discussions with contractor personnel can be readily accomplished. The supervisory auditor should particularly try to complete the review onsite in those instances where monitoring of audit progress or past experience indicates the existence of complex problems which require resolution.

l. On the more significant or sensitive assignments, the supervisory auditor and, in some cases, the FAO manager, should participate in entrance, exit, and other significant conferences held with the contractor.

m. The FAO manager is responsible for all aspects of the FAO operations. He or she establishes office procedures and management controls over the programming, scheduling, and timely completion of audits and reports. In some cases, as discussed in p. below, he or she may participate directly in audit assignments that are in process. In addition to day-to-day supervision of overall audit activities, he or she should review on a continual basis the status and progress of each team's performance.

n. The FAO manager should review all significant audit reports. The reviews should be in sufficient depth to provide continuing visibility into the technical proficiency of the audit efforts and the compliance with applicable Agency policies. He or she should also make selective examinations of working paper files with sufficient frequency to ensure that GAGAS field work and reporting standards are being observed. He or she should assure that technical problems which are expected to require referral to higher levels are brought to his or her attention as soon as practicable rather than at the time of final report review.

o. The FAO manager or acting FAO manager shall not redelegate signature authority on certain significant audit reports. DCAA Regulation No. 5600.1, Delegation of Signature Authority for Audit Reports and Other Audit Related Documents, establishes procedures for delegation and re delegation of authority to sign audit reports and identifies those audit reports for which signature authority cannot be redelegated.

p. The FAO manager may be more directly involved in audits of unusual materiality or sensitivity. He or she will also participate in supervising individual audit assignments

which involve significant administrative problems, such as denial of access to records or timeliness of reporting. He or she should attend any especially significant conferences with contractors.

### **2-302.3 Evidence (GAGAS 6.04b)**

The auditor must obtain sufficient evidence to provide a reasonable basis for the conclusion expressed in the report. This requires that sufficient procedures be performed to test the contractor's assertion to provide reasonable assurance that unallowable costs and other noncompliances with applicable Government laws and regulations are identified. The first step in obtaining sufficient evidence is to perform an adequate risk assessment to identify risk areas for the performance of substantive procedures. Substantive procedures include analytical procedures and detailed testing. The nature and extent of substantive procedures is a matter of auditor judgment based on the risk assessment. However, audit risk would never be low enough to eliminate the need for substantive procedures. Furthermore, inquiry and/or analytical procedures alone are not sufficient to support the high level of assurance provided in examination engagements. Detailed testing must be performed in all examination engagements. (Detailed guidance on audit evidence is in 3-204.14.)

### **2-303 Auditor Communication During Planning (GAGAS 6.06 – 6.08)**

When planning the audit, auditors should communicate certain information in writing to entity management, those charged with governance, and to the individuals requesting the engagement. In the Government contract audit environment, those charged with governance may be the same individuals within entity management that are responsible for overseeing the financial reporting process, subject matter, or program under audit and related internal controls.

a. Auditors should communicate in writing the following information related to the conduct and reporting of the audit to the individuals who requested the audit, i.e., normally the contracting officer (generally in the acknowledgement letter):

- The nature, timing, and extent of planned testing and reporting.
- The level of assurance the report will provide. This will generally be the type of engagement/audit service provided; e.g., examination or agreed-upon procedures.
- Any potential restriction on the auditor's report to reduce the risk that the needs or expectations of the parties involved may be misinterpreted. For example, DCAA audit reports generally include restriction on the release due to proprietary information and also state that the report should not be used for purposes other than action on the subject of the audit.

b. Auditors should also communicate the above information to the appropriate representatives of the organization audited (generally at the entrance conference). This will generally be the corporate controller, chief financial officer, or their designated representative; e.g., audit liaison).

c. If an audit is terminated and the assignment is cancelled before it is completed, auditors should write a memorandum for the record to fully document the work performed and why the audit was terminated/cancelled (see 4.403f). Generally, if notification/acknowledgment letters were issued to the contractor and contracting officer,

the auditor should also inform them that the audit has been terminated/cancelled and document that communication. If the contractor and contracting officer were notified of the assignment informally (e.g., verbally or e-mail), the auditor should also inform them that the audit has been terminated/cancelled in a similar manner and document that communication.

### **2-304 Audit Follow-up (GAGAS 6.09)**

Auditors should evaluate whether the contractor has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the subject matter. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current engagement.

a. Much of the benefit of audit work is not in the findings reported or the recommendations made, but in their effective resolution. Contractor management is responsible for resolving audit findings and recommendations. Continued attention to significant deficiencies and recommendations can help auditors assure that the benefits of their work are realized.

b. Known system deficiencies and recommendations from prior audits are summarized in the Contractor's Organization and Systems section of the audit report (see 10-210.7). The auditor should follow-up on those deficiencies that affect the scope of audit, determine whether the contractor has taken timely and appropriate corrective action, and report the status of uncorrected deficiencies.

### **2-305 Fraud, Illegal Acts, Violations of Provisions of Contracts (GAGAS 6.13 – 6.14)**

a. In planning examination-level contract audits, auditors are required to design the audit to provide reasonable assurance of detecting fraud, illegal acts, or violations of provisions of contracts or grant agreements (including applicable laws and regulations, e.g., FAR, CAS, TINA) that could have a material effect on the subject matter of the audit. Auditors should assess the risk of possible effects of material fraud, illegal acts, or violations of provisions of contracts or grant agreements on the subject matter of the audit. When risk factors are identified, auditors should document those factors, the auditors' response to those factors individually or in combination, and the auditors' conclusions.

b. Auditors are not expected to provide assurance of detecting potential fraud, illegal acts, or violations of provisions of contracts or grant agreements for review-level or agreed-upon procedure level engagements. Instead, if during the engagement, information comes to the auditors' attention indicating that such acts or violations that could have a material effect on the subject matter may have occurred, auditors should perform procedures as necessary to determine if such acts or violations are likely to have occurred and, if so, determine their effect on the results of the engagement.

c. To comply with this standard, the auditor is responsible for determining whether contractors have complied with contractual costing and pricing requirements (e.g., FAR, CAS, TINA). As a general rule, audit files should contain details concerning the laws and regulations pertinent to the Government contracts under audit. Additionally, liaison between the auditor and the administrative contracting officer should provide the information necessary to keep the files current.

d. In determining the nature, timing, and extent of the audit steps and procedures to test for compliance, the auditor should assess and document the risk of noncompliance with laws and regulations occurring and having a direct and material effect on the results of contract audits. The auditor should assess the risk that the entity did not comply with those laws and regulations and the risk that the entity's control structure to ensure compliance with laws and regulations might not prevent or detect that noncompliance.

e. Cost Accounting Standards (48 CFR Chapter 99) are issued to achieve:

(1) an increased degree of uniformity in cost accounting practices among Government contractors in like circumstances, and

(2) consistency in cost accounting practices in like circumstances by individual Government contractors over periods of time.

Increased uniformity and consistency in accounting improve understanding and communication, reduce the incidence of disputes and disagreements, and facilitate equitable contract settlements. FAR 30.202-6c and 30.202-7b outline the basic functions of the contract auditor in the implementation of the Cost Accounting Standards. The broad base of CAS coverage on DoD contracts, coupled with the number and scope of the standards promulgated, have had a substantive effect on DCAA audit procedures and responsibilities.

### **2-306 Internal Control (GAGAS 6.10 – 6.12)**

For examinations, GAGAS requires the auditor to obtain a sufficient understanding of the internal controls material to the subject matter to plan the audit and design procedures to achieve the objectives of the audit. This understanding should include knowledge of the contractor's control environment, information and communication methods, risk assessment processes, monitoring processes, and relevant control activities (see 5-102).

a. The control environment represents the collective effect of management's philosophy and operating style, the entity's organizational structure, the functioning of the board of directors and its committees, the methods of assigning authority and responsibility, management's control methods for monitoring and following up on performance, management's attitude toward internal and external audit, the entity's personnel policies and practices, and various other external influences that affect an entity's operations and practices. Judgments about the control environment may positively or negatively influence audit judgments about specific control activities.

b. The accounting system consists of the methods and records established to identify, assemble, analyze, classify, record, and report accounting transactions, and to maintain accountability for the related assets and liabilities. An effective accounting system identifies and records all valid transactions, describes transactions in sufficient detail to permit proper classification for financial reporting, measures the value of transactions in a manner that permits proper monetary recording, records transactions in the proper accounting period, and presents transactions properly in the financial statements or other financial representations.

c. At major and larger nonmajor contractors, the control environment and accounting system is a combination of interrelated accounting and management systems (see 5-102d).

d. Control activities are the policies and procedures that management has established to provide reasonable assurance that specific objectives will be achieved. Such control activities are classified as safeguarding controls and controls over compliance with laws

and regulations, and are integrated into specific components of the accounting and management systems.

(1) Safeguarding controls relate to the prevention or timely detection of unauthorized transactions and unauthorized access to assets. Such safeguarding controls might include:

- Proper authorization of transactions and activities.
- Segregation of duties that reduces the opportunities to allow any person to be in a position to both perpetrate and conceal errors or irregularities.
- Adequate safeguards over access to and use of assets and records, such as secured facilities and authorization for access to computer programs and files.

(2) Controls over compliance with laws and regulations provide for:

- Design and use of adequate documents and records to help ensure the proper recording of transactions and events.
- Independent checks on performance and proper valuation of recorded amounts, such as clerical checks, comparison of assets with recorded accountability, computer-programmed controls, and user review of computer-generated reports.

(3) The Agency's standard audit programs for Internal Control Audits and the related Internal Control Matrices (available on the DCAA Intranet and the APPS) identify specific control objectives, likely control activities for accomplishing those objectives, and audit procedures for evaluating the contractor's control activities.

### **2-306.1 Procedures to Obtain Understanding**

The audit team should perform procedures to obtain sufficient understanding of the contractor's internal controls (i.e., control environment, information and communication methods, risk assessment processes, monitoring processes, and relevant control activities) that are material to the subject matter of audit to plan the audit and design procedures to achieve the objectives of the audit. At major contractors, the procedures to gain this understanding are normally performed and documented in separate audits of the contractor's systems, and summarized on the internal control audit planning summary (ICAPS) forms in permanent files or the Internal Control Review System (ICRS) database (see 3-400 and 5-100). To the extent that this prior audit work does not provide the audit team with an understanding of internal controls material to the subject matter sufficient to plan the audit and design procedure to achieve the objectives of the audit, the scope of the current audit must be expanded to gain and document that understanding.

### **2-306.2 Assessing Control Risk and Designing Substantive Audit Tests**

a. Control risk is the likelihood that a material misstatement or noncompliance in an account or area subject to audit will not be prevented or detected on a timely basis by the contractor's internal controls. Assess this risk by gaining an understanding and evaluating the effectiveness of the control environment, information and communication methods, risk assessment processes, monitoring processes, and relevant control activities. The lower the assessed risk and materiality, the less evidence needed from substantive tests (i.e., detailed testing and analytical procedures) to form an opinion.

b. Control risk may not be assessed below maximum unless the effectiveness of the internal controls have been tested and found effective. The auditor may choose not to

perform the tests of controls needed to assess control risk below maximum when planning substantive audit tests because the contractor's internal controls are unlikely to be effective, or because it would be inefficient to evaluate their effectiveness.

c. Use the understanding of the internal control structure, the assessed level of control risk and consideration of inherent risk (see 2-302.1c) and materiality (see 2-309) to design substantive tests for auditing the contractor's cost estimates or representations. When the internal controls have been tested and determined to be effective, the auditor should rely on them and reduce the amount of substantive testing in the applicable audit area.

### **2-307 Working Papers/Documentation (GAGAS 6.20 – 6.26)**

a. Auditors must prepare attest documentation in connection with each engagement in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand from the documentation the nature, timing, extent, and results of procedures performed; and the evidence obtained and its source; and the conclusions reached. Working papers should also include evidence that supports the auditor's significant judgments and conclusions.

b. The auditor should prepare documentation that contains support for findings, conclusions, and recommendations before they issue the report. Documentation provides the principal support for:

- The statement in the report that the auditors performed the attestation engagement in accordance with GAGAS, and
- The auditors' conclusion.

c. GAGAS requires auditors to also document the following:

- The objectives, scope and methodology.
- The work performed to support significant judgments and conclusions, including descriptions (identification) of transactions and records examined. The information provided should be sufficient for an experienced auditor to examine the same transactions and records.
- Evidence of supervisory reviews of the work performed before the report is issued.
- The auditor's consideration that the planned procedures be designed to achieve the objectives of the engagement when evidence obtained is dependent on computerized information systems, that evidence is material to the objectives, and the auditor is not relying on the effectiveness of the internal controls over those computer systems that produced the evidence (see 5-111.1d).
- The auditor's departure from any applicable GAGAS requirements (due to law, regulation, scope limitations, restriction on access to records, etc); the impact on the engagement and on the auditors' conclusions. These circumstances would generally require a modified GAGAS statement (see 2-403).

d. When the timeliness of an audit report is critically important to a customer, it may be appropriate for an FAO to issue its report before completing its non-critical working papers; i.e., those working papers that do not impact the sufficiency of the documented audit evidence supporting the auditor's findings, conclusions, and recommendations. This would generally be administrative working papers. In these situations, the audit team should:

- (1) issue its audit report,
- (2) ensure the customer's immediate need for the audit report is documented in the working papers, and
- (3) complete any remaining non-critical working paper documentation as soon as possible.

In no case will the auditor issue an audit report when working papers supporting the audit findings, conclusions or recommendations are incomplete. For handling supplemental working papers, see 4-410.

e. Additional guidance concerning the sufficiency of audit evidence and working papers is presented in 3-204.14 and 4-400.

### **2-308 Developing Elements of Findings (GAGAS 6.15 – 6-19)**

Audit findings may involve deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse. The elements needed for a finding depend entirely on the engagement objectives. Thus a finding or set of findings is complete to the extent that the engagement objectives are satisfied. When auditors identify deficiencies, auditors should plan and perform procedures to develop the elements of the findings that are relevant and necessary to achieve the engagement objectives. The elements of a finding are criteria, condition, cause, and effect or potential effect.

### **2-309 Materiality (GAGAS 6.28)**

a. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of a subject matter or an assertion, while other matters are not important. In performing the engagement, matters that, either individually or in the aggregate, could be material to the subject matter are a primary consideration.

b. In engagements performed in accordance with GAGAS, it may be appropriate to use lower materiality levels as compared with the materiality levels used in non-GAGAS engagements because of the public accountability of Government entities and entities receiving Government funding, various legal and regulatory requirements, and the visibility and sensitivity of Government programs.

## **2-400 Section 4 --- Reporting Standards**

### **2-401 Introduction**

The Generally Accepted Government Auditing Standards (GAGAS) for attestation engagements incorporate the AICPA attestation engagement reporting standards, unless specifically excluded or modified by GAGAS, and prescribe additional standards. This section explains how GAGAS reporting standards are integrated with contract audit field work guidance.

### **2-402 AICPA Reporting Standards for Attestation Engagements (GAGAS 6.30)**

The four AICPA reporting standards that apply to all levels of attestation engagements are discussed below.

#### **2-402.1 Subject and Character of Engagement**

The auditor must identify the subject matter or the assertion being reported on and state the character of the engagement in the report. The statement of the character of the engagement includes a description of the nature and scope of the work performed and a reference to the governing professional standards (GAGAS). Guidance on implementing this standard in general is in 10-210.1. Other sections of Chapter 10 provide additional guidance applicable to particular types of reports.

#### **2-402.2 Conclusion**

The auditor must state the conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated in the report. Guidance on implementing this standard in general is in 10-210.5. Other sections of Chapter 10 provide additional guidance applicable to particular types of reports.

#### **2-402.3 Significant Reservations**

The auditor must state all of the significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto in the report.

a. Reservations about the engagement refer to any unresolved problem the auditor had in complying with applicable GAGAS requirements (e.g., the auditor was not able to perform all the procedures that he or she considers necessary in the circumstances) or, in an agreed-upon procedures engagement (AUP), the specific procedures agreed to. This type of reservation results in either a qualified or disclaimer of opinion (see 2-102.2) and requires a modified GAGAS statement (see 2-403). In addition, the reservations are discussed in the scope section of the report. The presentation of this discussion in the report will vary slightly depending on the type of engagement and the type of opinion expressed. For examinations where the reservations about the engagement result in a qualified opinion, the circumstances are discussed under the subheading “Qualification” (see 10-210.4). However, if an adverse opinion is being expressed (because there is also a reservation about the subject matter – see paragraph b below), the subheading “Scope Restriction” rather than “Qualification” should be used (see 10-210.4i). If the omitted

procedures are so significant that a disclaimer of opinion is expressed the section title “Scope of Audit” should be changed to “Scope Restriction” (see 10-210.3b). For AUPs see 10-1008.

b. Reservations about the subject matter or the assertion refer to any unresolved reservation about the conformity of the subject matter with the criteria, including the adequacy of the disclosure of material matters (e.g., the assertion is incomplete or inaccurate or there are noncompliances with FAR or CAS). In DCAA audits, this type of reservation generally results in reported findings such as questioned costs, deficiencies, noncompliances, etc. These reservations are generally discussed in the audit report exhibits and explanatory notes or statement of conditions and recommendations, etc. Under the attestation standards, reservations about the subject matter or assertion result in either a qualified or adverse opinion depending on the materiality of the departure from the criteria (see 2-102.2). This type of reservation does not require a modified GAGAS statement unless the circumstances also result in a reservation about the engagement. For example, a contractor’s denial of access to records may result in both reservations about the engagement and reservations about the subject matter.

#### **2-402.4 Restrictions on Use of Report**

a. The auditor must state in the report that the report is intended for use by specified parties under certain circumstances; e.g., when the criteria used to evaluate the subject matter are appropriate for or available to only limited or specified parties.

b. Restrictions on the use of a report may result from a number of circumstances, including; the purpose of the report, the criteria used in preparation of the subject matter, the extent to which the procedures performed are known or understood, and the potential for the report to be misunderstood when taken out of context in which it was intended to be used. For example, the purpose of the restriction on the use of the agreed-upon procedures report is to restrict its use to only those parties that have agreed upon the procedures performed and taken responsibility for the sufficiency of the procedures. See 10-206.1 for guidance on restrictions included in DCAA reports.

#### **2-403 Reporting Compliance with Generally Accepted Government Auditing Standards (GAGAS 6.32 and 1.12)**

a. When auditors comply with all applicable GAGAS requirements, they should include a statement in the report that they performed the engagement in accordance with GAGAS.

b. If the auditor did not follow all the applicable standards during the audit the GAGAS compliance statement should be modified as follows depending on the significance of the departure from GAGAS (see 2-402.3a).

(1) To state that the auditor performed the engagement in accordance with GAGAS, except for specific applicable requirements that were not followed, or

(2) To state that because of the significance of the departure(s) from the requirements, the auditor was unable to and did not perform the engagement in accordance with GAGAS.

c. When auditors use a modified GAGAS statement, they should disclose in the report the applicable requirement(s) not followed, the reason for not following it, and how not

following the requirements affected, or could have affected the audit and the assurance provided. In DCAA audit reports, this information is generally included in the “Scope of Audit” section under the subheading “Qualifications” for cases covered in (1) above (see 10-210.4) or under the “Scope Restrictions” section for cases covered by (2) above (see 10-210.3b).

**2-404 Reporting Deficiencies in Internal Controls, Fraud, Illegal Acts, Violations of Provisions of Contracts (GAGAS 6.33 – 6.38)**

a. For attestation engagements performed under GAGAS auditors should report, as applicable to the objectives of the engagement and based on the work performed:

(1) significant deficiencies in internal control, identifying those considered to be material weaknesses (see 2-404g and h);

(2) all instances of fraud and illegal acts unless inconsequential (however, see paragraph c below); and

(3) violations of provisions of contracts or grant agreements and abuse that could have a material effect on the subject matter of the engagement.

b. To comply with these requirements, audit reports should either:

(1) describe the scope of the auditor’s testing of compliance with applicable laws and regulations and testing of internal control (if performed) and present the results of those tests; or

(2) refer to separate reports containing that information (see 5-100 and 10-400).

In presenting the results of those tests, the auditor should report all violations of provisions of contracts that are material, other material noncompliances, and significant deficiencies/material weaknesses in internal control applicable to the subject matter, or assertion of the engagement.

c. When fraud or suspected irregularities are discovered, DCAA policy is for the auditor to prepare a Form 2000 (see 4-700) instead of including the issue in the audit report. There is no requirement for the auditor to prove the existence of fraud or other contractor irregularities to submit a DCAA Form 2000. The auditor is merely reporting the suspicion of irregularities to the appropriate investigative agencies.

d. GAGAS also requires the reporting of abuse that is material to the subject matter. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of contracts. CAM Sections 4-803 and 4-804 address audit responsibilities relating to suspected abuse or unsatisfactory conditions.

e. When auditors report separately on compliance and internal control, audit reports of other related audits should reference those additional reports and state that the separate report is an integral part of the audit and should be considered in assessing the results of audit (see 10-210.3f and 10-210.7).

f. Auditors should report deficiencies in internal controls and noncompliances that are material to the subject matter or assertion on a “real time basis” using a flash report (see 10-413 and 10-808). For internal control deficiencies, the auditor should also establish a separate limited scope audit assignment to review the control activities related to the applicable control objective. The limited scope audit assignment should be completed as soon as possible after the condition is identified.

g. With respect to Government contracting, a significant deficiency is an internal control deficiency, or combination of deficiencies that

(1) adversely affects the contractor's ability to initiate, authorize, record, process, or report Government contract costs in accordance with applicable Government contract laws and regulations,

(2) results in at least a reasonable possibility that unallowable costs will be charged to the Government, and

(3) the potential unallowable cost is not clearly immaterial.

h. A material weakness is a significant deficiency (or combination of significant deficiencies) that results in or could result in material unallowable costs being charged to the Government.

i. Since DCAA only performs internal control audits on systems that are material to Government contract costs, significant deficiencies identified in DCAA audits will generally be those considered to be material weaknesses (i.e., the impact or potential impact to Government contract costs is material). Therefore, all internal control deficiencies that result in or could result in unallowable costs being charged to the Government should be reported as significant deficiencies and be considered material weaknesses, unless the potential unallowable cost is clearly immaterial.

#### **2-405 Reporting Views of Responsible Officials (GAGAS 6.44 – 6.50)**

If the auditors' report discloses deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts, or abuse, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions. In instances of suspected irregularities DCAA guidance is to issue a Form 2000 and auditors should follow guidance in 4-700 regarding discussions with the contractor.

#### **2-406 Reporting Confidential or Sensitive Information (GAGAS 6.51 – 6.55)**

If certain pertinent information is prohibited from public disclosure or is excluded from a report due to the confidential or sensitive nature of the information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that make the omission necessary. DCAA audit reports generally include sensitive and confidential information that is subject to regulatory or statutory restrictions. As a result, DCAA reports are restricted from the release (see 2-402.4).

#### **2-407 Distributing Reports (GAGAS 6.56)**

Audit organizations in government entities should distribute reports to those charged with governance, to the appropriate entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the engagement. Copies of the reports should also be sent to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations, and to others authorized to receive such reports. Auditors should document any limitations on report distribution. DCAA normally submits the audit report to the contracting officer responsible for acting on the audit recommendations. The contracting officer provides the report to the contractor at their discretion.

### **2-408 Application of the Reporting Standards**

DCAA has developed reporting guidance (see Chapter 10) which complies with all aspects of the GAGAS, including the AICPA standards and requirements for attestations.

**2-500 Section 5 --- Field Work Standards for Operations Audits (Performance Audits)****2-501 Introduction (GAGAS 7.01 – 7.02)**

In the contract audit environment, performance audits are more commonly described as operations audits. Those audits seek to determine if the contractor is operating in an economical and efficient manner. Economy and efficiency relate to the reasonableness of costs charged to Government contracts, but also impacts areas such as program schedules. Inefficient operations can result in schedule slippages and contract overruns. Examples of operations audits performed by DCAA include; labor and facilities utilization, and materials inventory management. Chapter 7 of the Yellow Book establishes the field work standards and guidance for performance audits and apply to operations audits performed by DCAA. The fieldwork standards for performance audits relate to planning the audit; supervising the staff; obtaining sufficient, appropriate evidence, and preparing audit documentation. The concepts of reasonable assurance, significance, and audit risk form a framework for applying these standards.

**2-501.1 Reasonable Assurance (GAGAS 7.03)**

Operations audits that comply with GAGAS provide reasonable assurance that evidence is sufficient and appropriate to support findings and conclusions. The sufficiency and appropriateness of evidence needed and tests of evidence will vary based on the audit objectives, findings, and conclusions. Audit objectives for operations audits range from narrow to broad and involve varying types and quality of evidence. In some audits, sufficient, appropriate evidence is available, but in others, information may have limitations. Professional judgment assists auditors in determining the audit scope and methodology needed to address the audit objectives, while providing the appropriate level of assurance that the obtained evidence is sufficient and appropriate to address the audit objectives.

**2-501.2 Significance in a Performance (Operations) Audit (GAGAS 7.04)**

The concept of significance assists auditors throughout an operations audit, including when deciding the type and extent of audit work to perform, when evaluating results of audit work, and when developing the report and related findings and conclusions. Significance is defined as the relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors. Such factors include the magnitude of the matter in relation to the subject matter of the audit, the nature and effect of the matter, the relevance of the matter, the needs and interests of an objective third party with knowledge of the relevant information, and the impact of the matter to the audited program or activity. Professional judgment assists auditors when evaluating the significance of matters within the context of the audit objectives.

### **2-501.3 Audit Risk (GAGAS 7.05)**

Audit risk is the possibility that the findings, conclusions, recommendations, or assurance may be improper or incomplete, as a result of factors such as evidence that is not sufficient and/or appropriate, an inadequate audit process, or intentional omissions or misleading information due to misrepresentation or fraud. The assessment of audit risk involves both qualitative and quantitative considerations. Factors such as the complexity or sensitivity of the work, size of the program operations in terms of dollar amounts, and adequacy of the audited entity's systems, and access to records, also impact audit risk. Audit risk includes the risk that auditors will not detect a mistake, inconsistency, significant error, or fraud in the evidence supporting the audit. Audit risk can be reduced by taking actions such as increasing the scope of work, adding experts, additional reviewers and other resources to the audit team; changing the methodology to obtain additional evidence, higher quality evidence, or alternative forms of corroborating evidence; or aligning the findings and conclusions to reflect the evidence obtained.

### **2-502 Planning (GAGAS 7.06 – 7.15)**

a. Auditors must adequately document the planning of the work necessary to address the audit objectives. Auditors must plan the audit to reduce audit risk to an appropriate level to provide reasonable assurance that the evidence is sufficient and appropriate to support findings and conclusions. This determination is a matter of professional judgment. In planning the audit, auditors should assess significance and audit risk and apply these assessments in defining the audit objectives and the scope and methodology to address those objectives. Planning is a continuous process throughout the audit. Therefore, auditors may need to adjust the audit objectives, scope, and methodology as work is being completed.

b. Adequate planning for operations audits should include evaluation of internal audit reports, capital budgets, consideration of the results of previous performance and attestation audits that could affect the current audit objectives, and other contractor information related to the prospective audit. The criteria for assessing performance should be established. Sufficient staff and specialists with adequate collective profession competence should be assigned and other resources needed should be identified. The auditors should gain an understanding of applicable legal and regulatory requirements and contracts provisions, potential fraud or abuse (see 2-504) that are significant within the context of the audit objectives. Auditors should also obtain an understanding of internal control as it relates to the specific objective and scope of the audit and determine whether it is necessary to evaluate information systems (see 2-505).

c. Written audit programs are essential to conducting audits efficiently and effectively and should be prepared for each audit. Audit programs provide:

(1) A description of the audit methods and suggested audit steps and procedures to be conducted to accomplish the audit objectives.

(2) A systematic basis for assigning work to supervisors and staff.

(3) The basis for a summary record of work.

d. Auditors should communicate an overview of the objective, scope, and methodology, and timing of the audit and planned reporting (including any potential

restrictions on the report) to contractor management; including those with sufficient authority and responsibility to implement corrective action in the program or activity being audited and the individuals contracting for or requesting the audit services.

### **2-503 Supervision (GAGAS 7.52 – 7.54)**

a. The audit supervisors or those designated to supervise auditors must properly supervise the audit staff. Audit supervision involves providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable standards, while staying informed about significant problems encountered, reviewing the work performed, and providing effective on-the-job training. The nature and extent of the supervision of staff and the review of audit work may vary depending on a number of factors, such as the size of the audit organization, the significance of the work, and the experience of the staff.

b. Supervisory reviews of audit work and the report should be timely and must be performed and documented in the working papers before the report is issued. Supervisory reviews of the work conducted should include verification that:

- (1) the auditors conformed to the auditing standards,
- (2) the audit programs are followed, unless deviation is justified and authorized,
- (3) the working papers adequately support findings and conclusions (see 2-507 for the GAGAS on documentation),
- (4) the working papers provide adequate evidence to prepare a meaningful report, and
- (5) the audit team accomplished the audit objectives.

### **2-504 Legal and Regulatory Requirements, Fraud and Abuse (GAGAS 7.28 – 7.35)**

a. Auditors should determine which laws, regulations and provisions of contracts are significant within the context of the audit objectives and assess the risk that violations could occur. Based on that risk assessment, the auditor should design and perform procedures to provide reasonable assurance of detecting instances of violations of legal and regulatory requirements or contract provisions that are significant in the context of the audit objectives.

b. The assessment of audit risk may be affected by such factors as the complexity of the laws, regulations, and provisions of contracts. The assessment of audit risk also may be affected by whether the entity has controls that are effective in preventing or detecting violations of laws, regulations, and provisions of contracts. If auditors obtain sufficient, appropriate evidence of the effectiveness of these controls, they can reduce the extent of their tests of compliance.

c. In planning the audit, auditors should assess risks of fraud occurring that is significant within the context of the audit objectives. Team members should discuss fraud risks, including factors such as incentives or pressures to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could allow individuals to commit fraud. Auditors should gather and assess information to identify risks of fraud that are significant within the scope of the audit objectives or that could affect the findings and conclusions. For example, auditors may obtain information through discussion with officials of the audited entity or through other means to determine the susceptibility of the program to fraud, the status of internal controls the

entity has established to detect and prevent fraud, or the risk that officials of the audited entity could override internal control. An attitude of professional skepticism in assessing these risks assists auditors in assessing which factors or risks could significantly affect the audit objectives.

d. When auditors identify factors or risks related to fraud that has occurred or is likely to have occurred that they believe are significant within the context of the audit objectives, they should design procedures to provide reasonable assurance of detecting such fraud. Assessing the risk of fraud is an ongoing process throughout the audit and relates not only to planning the audit, but also to evaluating evidence obtained during the audit.

e. When information comes to the auditor's attention indicating fraud that is significant within the context of the audit objectives may have occurred, auditors should extend the audit steps and procedures, as necessary, to (1) determine whether fraud has likely occurred and (2) if so, determine its effect on the audit findings. If the fraud that may have occurred is not significant within the context of the audit objectives, the auditors may conduct additional audit work as a separate engagement, or refer the matter to other parties with oversight responsibility or jurisdiction (see 4-700).

f. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider a reasonable and necessary business practice given the facts and circumstances. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of contracts. If during the course of the audit, auditors become aware of abuse that could be significant to the program under audit, auditors should apply audit procedures specifically directed to ascertain the potential effect on the area under audit. After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts. Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse (see 4-800).

g. When investigations or legal proceedings are initiated or in process, auditors should evaluate the impact on the current audit. In some cases, it may be appropriate for the auditors to work with investigators and/or legal authorities, or withdraw from or defer further work on the audit or a portion of the audit to avoid interfering with an investigation (see 4-702.5).

## **2-505 Considering Internal Controls (GAGAS 7.16 - 7.22)**

a. Auditors should obtain an understanding of internal controls that are significant within the context of the audit objectives. For internal controls that are significant within the context of audit objectives, auditors should assess whether the internal controls have been properly designed and implemented. For those internal controls that are deemed significant within the context of the audit objectives, auditors should plan to obtain sufficient, appropriate evidence to support their assessment about the effectiveness of those controls. Information systems controls are often an integral part of an entity's internal control. Thus, when obtaining an understanding of internal control significant to the audit objectives, auditors should also determine whether it is necessary to evaluate information systems controls.

b. An assessment should be made of applicable internal controls when necessary to satisfy the audit objectives. The assessment should include a survey of management policies, procedures, practices, and internal controls applicable to any aspect of the activities in which

the auditor attempts to judge whether existing practices can be made significantly more efficient or economical. The audited entity is responsible for establishing effective internal controls. Auditors may modify the nature, timing or extent of audit procedures based on the assessment of internal controls and the results of internal control testing.

c. The following discussion of the principal types of internal control objectives is intended to help auditors better understand internal controls and determine whether or to what extent they are significant to the audit objectives.

(1) Effectiveness and efficiency of operations: Controls over operations include policies and procedures that the audited entity has implemented to provide reasonable assurance that the operation meets its objectives, while considering cost-effectiveness and efficiency. Understanding these controls can help auditors understand the program operations.

(2) Relevance and reliability of information: Controls over the relevance and reliability of information include policies, procedures, and practices that officials of the audited entity have implemented to provide themselves reasonable assurance that operational and financial information they use for decision making and reporting externally is relevant and reliable and fairly disclosed in reports. Understanding these controls can help auditors assess the risk that the information gathered by the entity may not be relevant or reliable and design appropriate tests of the information considering the audit objectives.

(3) Compliance with applicable laws and regulations and provisions of contracts or grant agreements: Controls over compliance include policies and procedures that the audited entity has implemented to provide reasonable assurance that program implementation is in accordance with laws, regulations, and provisions of contracts or grant agreements. Understanding the relevant controls concerning compliance with those laws and regulations and provisions of contracts or grant agreements that the auditors have determined are significant within the context of the audit objectives can help them assess the risk of illegal acts, violations of provisions of contracts or grant agreements, or abuse.

d. Costs result from implementation of management policies and decisions. Accordingly, the evaluation of these policies and decisions, and the effectiveness of management controls over their implementation, will also significantly influence the scope and nature of the audit. Ideally, management policies and decisions should be geared toward prudent, effective, and economical operations, and reflect adequate consideration of the interests of both the contractor and the Government. Ideal conditions are seldom found. As an illustration, the retention of a large engineering staff during periods of significantly declining sales volume may well serve the contractor's interest in terms of maintaining a capability to expand efforts in bidding for new business. However, unless the auditor questions the increased overhead rate that results from such a decision, the costs of current Government contracts will be inflated, thereby adversely affecting the Government's interest. Where management policies and decisions are motivated by contractor interests that are not compatible with those of the Government, the examination of questionable cost areas should be intensified.

### **2-505.1 Information Systems Controls (GAGAS 7.23 – 7.27)**

Understanding information systems controls is important when information systems are used extensively throughout the program under audit and the fundamental business processes related to the audit objectives rely on information systems. An organization's use of information systems controls may be extensive; however, auditors are primarily interested in those information systems controls that are significant to the audit objectives. Information

systems controls are significant to the audit objectives if auditors determine that it is necessary to evaluate the effectiveness of information systems controls in order to obtain sufficient, appropriate evidence. Auditors should obtain a sufficient understanding of information systems controls necessary to assess audit risk and plan the audit within the context of the audit objectives.

### **2-506 Obtaining Sufficient, Appropriate Audit Evidence (GAGAS 7.55 – 7.71)**

a. Auditors must obtain sufficient, appropriate audit evidence to provide a reasonable basis for their findings and conclusions.

b. Appropriateness is the measure of the quality of the evidence that encompasses its relevance, validity and reliability in supporting audit objectives and related findings. In assessing the overall appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable.

(1) Relevance refers to the extent to which evidence has a logical relationship with, and importance to, the issue being addressed.

(2) Validity refers to the extent to which evidence is based on sound reasoning or accurate information.

(3) Reliability refers to the consistency of results when information is measured or tested and includes the concepts of being verifiable or supported.

c. Sufficiency is a measure of the quantity of evidence used to support the findings and conclusions related to the audit objectives. In assessing the sufficiency of evidence, auditors should determine whether enough evidence has been obtained to persuade a knowledgeable person that the findings are reasonable.

d. Evidence may be categorized as physical, documentary, and testimonial. (See 3-204.14 for more details on evidence.)

e. In assessing evidence, auditors should assess whether the evidence taken as a whole is sufficient and appropriate for addressing the audit objectives and supporting final audit findings and conclusions.

### **2-507 Working Papers/Audit Documentation (GAGAS 7.77 - 7.84)**

a. Auditors must prepare audit documentation related to planning, conducting, and reporting for each audit. Working papers should contain sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the working papers the nature, timing, extent, and results of procedures performed and the evidence obtained and its source and the conclusions reached, including evidence that supports the auditor's significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, recommendations before auditors issue their report.

b. Auditors should design the form and content of audit documentation to meet the circumstances of the particular audit. The audit documentation constitutes the principal record of the work performed in accordance with standards and the conclusions reached. The quantity, type, and content of audit documentation are a matter of professional judgment.

c. Audit documentation is an essential element of audit quality. The process of preparing and reviewing audit documentation contributes to the quality of an audit. Audit documentation serves to:

- (1) Provide the principal support for the auditors' report,
  - (2) aid auditors in conducting and supervising the audit, and
  - (3) allow for the review of audit quality.
- d. GAGAS requires auditors to document:
- (1) The objectives, scope, and methodology of the audit;
  - (2) The work performed to support significant judgments and conclusions, including descriptions of transactions and records examined;
  - (3) Evidence of supervisory review, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report; and
  - (4) The auditor's departure from any applicable GAGAS requirements (due to law, regulation, scope limitations, restriction on access to records, etc.) and the impact on the audit and on the auditors' conclusions. These circumstances would generally require a modified GAGAS statement (see 2-603e).

## **2-600 Section 6 --- Reporting Standards for Operations Audits (Performance Audits)**

### **2-601 Introduction**

Chapter 8 of the Yellow Book establishes reporting standards and provides guidance for performance audits conducted in accordance with GAGAS. This section discusses the form of the report, report contents, and report issuance and distribution. The reporting standards explained in this section apply only to DCAA operations audits. Section 10-400 provides reporting guidance for DCAA operations audits that fully complies with these reporting standards.

### **2-602 Reporting (GAGAS 8.03 – 8-07)**

Auditors must issue audit reports communicating the results of each completed performance (e.g., operations) audit. The form of the audit report should be appropriate for its intended use and should be written or in some other retrievable form.

a. The purposes of the audit reports are to:

(1) Communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials (usually the contracting officer);

(2) make the results less susceptible to misunderstanding; and

(3) facilitate follow-up to determine whether appropriate corrective actions have been taken.

b. If an audit is terminated before it is completed, and no report is issued, auditors should document the results of the work to the date of termination and why the audit was terminated (see 4.403f). The auditor should also communicate the reason for terminating the audit to contractor management, and the requestor, preferably in writing.

c. If after the report is issued, the auditors discover that they did not have sufficient, appropriate evidence to support the reported findings or conclusions, they should communicate with those charged with governance, the appropriate officials of the audited entity, and the appropriate officials of the organizations requiring or arranging for the audits, so that they do not continue to rely on the findings or conclusions that were not supported. The auditors should then determine whether to conduct additional audit work necessary to reissue the report with revised findings or conclusions.

### **2-603 Report Contents (GAGAS 8.08 – 8.42)**

Auditors should prepare audit reports that contain the objectives, scope, and methodology of the audit; the audit results, including findings, conclusions, and recommendations, as appropriate; a statement about compliance with GAGAS; a summary of the views of responsible officials; and if applicable, the nature of any confidential or sensitive information omitted.

a. Objectives, Scope, and Methodology (GAGAS 8.09 – 8.13): The report should include the objectives in a clear, specific, neutral and unbiased manner that includes relevant assumptions including the purpose of the audit and report. The report should describe the scope of the work performed and any limitations, including issues that would be relevant to likely users, so that they could reasonably interpret the findings, conclusions, and recommendations in the report without being misled. The audit report

should also include information on any significant constraints imposed by information limitations or scope impairments, including denials of access to certain records or individuals. In reporting audit methodology, auditors should explain how the completed audit work supports the audit objectives, including the evidence gathering and analysis techniques, in sufficient detail to allow knowledgeable users of the report to understand how the auditor addressed the audit objectives.

b. Audit Findings (GAGAS 8.14 – 8.18): The report should present sufficient, appropriate evidence to support the findings in relation to audit objectives. Clearly developed findings assist the governing agency and the contractor's management in understanding the need for taking corrective action. The findings should be in perspective by describing the nature and extent of the issues reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors should, as applicable, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value, or other measures, as appropriate.

c. Audit Conclusions (GAGAS 8.27): Auditors should report conclusions, as applicable, based on the audit objectives and the audit findings. Report conclusions are logical inferences about the contractor's operations based on the auditor's findings, not merely a summary of the findings. The strength of the conclusions depends on the sufficiency and appropriateness of the evidence supporting the findings and the soundness of the logic used to formulate the conclusions. Conclusions are stronger if they lead to the auditors' recommendations and convince the knowledgeable user of the report that action is necessary.

d. Recommendations (GAGAS 8.28): Auditors should recommend actions to correct problems identified during the audit and to improve programs and operations when reported findings and conclusions substantiate the potential for improvement in programs, operations, and performance. Effective recommendations encourage improvements in the conduct of programs and operations. Recommendations should flow logically from the findings and conclusions, seek to resolve the cause of identified problems, and clearly state the actions recommended.

e. Reporting Compliance with GAGAS (GAGAS 8.30 – 8.31): When the auditor complies with all applicable GAGAS requirements, GAGAS 8.30 requires that the report include specific language which represents an unmodified GAGAS statement. That language is included in the operations audit report shells delivered by APPS. When the audit does not comply with all applicable GAGAS requirements, the report should include a modified GAGAS compliance statement (see 2-403).

f. Fraud, Illegal Acts, Violations of Provisions of Contracts, and Abuse (GAGAS 8.21 – 8.23): Under GAGAS when auditors conclude, based on sufficient, appropriate evidence that fraud, illegal acts, significant violations of provisions of contracts, or significant abuse either has occurred or is likely to have occurred, they should report the matter as a finding. However, when fraud or suspected irregularities are discovered, DCAA policy is for the auditor to prepare a Form 2000 (see 4-700). When auditors detect violations of provisions of contracts or abuse that are not significant, they should communicate those findings in a separate letter to officials of the audited entity (or in a separate appendix of the audit report) unless the findings are clearly inconsequential, considering both qualitative and quantitative factors. If the auditors have communicated instances of violations of provisions of contracts or abuse in a separate letter to officials of the audited entity, they should refer to that letter in the audit report.

g. Internal Controls (GAGAS 8.19 – 8.20): The audit report should include (1) the scope of work on internal control and (2) any deficiencies in internal control that are significant within the context of the audit objectives and based upon the audit work performed. When auditors detect deficiencies in internal control that are not significant to the objectives of the audit, they may communicate those deficiencies in a separate letter to appropriate officials of the audited entity unless the deficiencies are clearly inconsequential considering both qualitative and quantitative factors. If the auditors have communicated deficiencies in a separate letter to officials of the audited entity, they should refer to that letter in the audit report.

h. Views of Responsible Officials (GAGAS 8.32 – 8.37): Providing a draft report with findings for review and comments by the responsible officials of the audited entity helps the auditor develop a report that is fair, complete, and objective. Including the views of responsible officials results in a report that presents not only the auditors' findings, conclusions, and recommendations, but also the perspectives of the responsible officials of the audited entity and the corrective action they intend to take. Written comments are preferable, but oral comments are acceptable.

i. Privileged and Confidential Information (GAGAS 8.38 – 8.42): If certain information is prohibited from general disclosure due to the confidential or sensitive nature of that information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that makes the omission necessary.

j. Report Quality Elements (GAGAS A8.02): The auditor may use the report quality elements of timely, complete, accurate, objective, convincing, clear, and concise when developing and writing the report as the subject permits.

(1) An accurate report is supported by sufficient, appropriate evidence with key facts, figures, and findings being traceable to the audit evidence.

(2) Objective means that the presentation of the report is balanced in content and tone.

(3) Being complete means that the report contains sufficient, appropriate evidence needed to satisfy the audit objectives and promote an understanding of the matters reported.

(4) Being convincing means that the audit results are responsive to the audit objectives, that the findings are presented persuasively, and that the conclusions and recommendations flow logically from the facts presented.

(5) Clarity means the report is easy for the intended user to read and understand.

(6) Being concise means that the report is not longer than necessary to convey and support the message.

(7) To be of maximum use, providing relevant evidence in time to respond to officials of the audited entity, and other users' legitimate needs is the auditors' goal. Likewise, the evidence provided in the report is more helpful if it is current. Therefore, the timely issuance of the report is an important reporting goal for auditors. During the audit, the auditors may provide interim reports of significant matters to appropriate entity officials. Such communication alerts officials to matters needing immediate attention and allows them to take corrective action before the final report is completed.

**2-604 Report Distribution (GAGAS 8.43)**

Under GAGAS, auditors should submit audit reports to those charged with governance, the appropriate officials of the audited entity, and to the appropriate oversight bodies or organizations requiring or arranging for the audits. Copies of the reports should also be sent to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. DCAA normally submits the audit report to the contracting officer responsible for acting on the audit recommendations and a copy of the report is provided to the contractor through the contracting officer. Chapter 10 specifies disclosure restrictions applicable to contract audits performed by DCAA.

## **2-S10 Supplement --- Description of DCAA Quality Control System**

### **2-S101 Introduction**

DCAA's quality control program is an important element of the Agency's overall focus on quality which emphasizes "prevention" as a means for reducing errors and rework. To further ensure that quality is being achieved, it also provides for an adequate level of monitoring and inspection. As an agency that provides professional services, DCAA has a responsibility to establish and conform to professional standards. To meet this responsibility, DCAA has established standards based on generally accepted government auditing standards which incorporate the standards of the American Institute of Certified Public Accountants. To ensure that it provides professional services that conform with professional standards, DCAA is required to have a system of quality control and, indeed, maintains such a system. The authority for and descriptive details of this system can be found in the various official pronouncements and Agency publications, including the DCAA Charter, Instructions, Manuals, and other DCAA directives. A summary description of the system follows.

### **2-S102 Philosophy, Organization, and Approach to Providing Quality Services**

#### **2-S102.1 Philosophy**

DCAA is an independent audit agency within the Department of Defense (DoD) with a mission to perform contract audits and provide all necessary accounting and financial advisory services for the DoD, and other agencies by serving the public interest as its primary customer and ensuring that taxpayer dollars are spent on fair and reasonable contract prices. In accomplishing this mission, the Director of DCAA has fully committed the Agency staff to attain the highest level of integrity and competence. This is best explained through our vision statement set forth as follows:

“Dedicated professionals working together to deliver top-quality audit services to support the Department and the warfighter and to protect the taxpayer’s interest.”

Good working relationships and open communications with our stakeholders will minimize potential conflicts between their needs and the Agency's requirement to perform contract audits that conform with generally accepted government auditing standards.

#### **2-S102.2 Organization**

DCAA’s basic system of quality control encompasses the Agency’s organizational structure, as detailed in the DCAA Organization Manual (DCAAM 5110.1), and outlined below.

##### **a. Headquarters**

(1) Office of the Director. DCAA's Director reports to the Under Secretary of Defense (Comptroller) and exercises worldwide direction of the Agency in performing all contract audits for DoD and other agencies upon request. The Director's staff includes a Deputy Director, five Assistant Directors, a General Counsel, an Executive Officer, and a Special Assistant for Quality Management. The Director is the senior

management official responsible for establishing policies and procedures for the management control program in conjunction with the Federal Managers' Financial Integrity Act (FMFIA). The Executive Officer (DX) serves as the focal point for developing regulations and guidance, accumulating information, and drafting the Director's annual statement required under the FMFIA. DX monitors tests of critical management controls performed by others as reported through the FMFIA process. DX also advises the Director and Deputy Director on any sensitive matters disclosed by quality or management control reviews reported through the FMFIA process. The Special Assistant for Quality Management (DQ) assists the Director and Deputy Director in administering the Agency's Strategic Plan and in fostering continuous process improvement.

(2) Assistant Directors.

(a) Operations. Responsible and accountable for providing technical guidance and direction to the Agency for field contract audit operations. This includes directing the development of Agency audit objectives, activities, operational schedules, and priorities to assure effective accomplishment of field contract audit operations.

(b) Policy and Plans. Responsible and accountable for directing the formulation and development of DCAA contract audit policy and for the coordination, issuance, and integration of this policy. Assigned divisions include: Accounting and Cost Principles (PAC), Auditing Standards (PAS), Policy Programs (PPD), Pricing and Special Projects (PSP), and Policy Publications and Systems (PPS). DCAA's auditing standards subject matter experts (a Division Chief and several program managers) reside in the PAS Division. PAS is dedicated solely to activities related to the development and formulation of DCAA's contract audit policy for compliance with auditing standards (GAGAS, SSAEs, SAS, etc.), including but not limited to the following program areas: independence (including nonaudit services), professional judgment, competence, planning and supervision, auditor communication, sufficient evidence/adequate testing, internal controls, assessing the risk of fraud, audit documentation, reporting, and agreed-upon procedures. For example, PAS monitors and researches relevant auditing standards and develops or revises guidance as needed; develops or provides advice on the development of training related to auditing standards; responds to inquiries from regional and field offices; identifies problems with implementation of guidance and determines the need for revision; reviews the work of other Policy divisions for compliance with auditing standards; and provides technical assistance to other Headquarters elements on issues with auditing standards implications. When appropriate, PAS seeks advice from the GAO on the interpretation and implementation of GAGAS related to complex audit policy issues and unusual independence questions using the contact information for technical and practice questions posted to the GAO website ([yellowbook@gao.gov](mailto:yellowbook@gao.gov)). PAS also consults with other organizations, such as the AICPA and DoDIG, to obtain technical advice on auditing standards issues.

(c) Resources. Responsible and accountable for formulating, directing, and executing plans, programs, policies, and procedures related to the management of DCAA resources including financial management, personnel management and administration, information resources management, management analysis, security, and general administration activities.

(d) Integrity and Quality Assurance. Responsible and accountable for monitoring the system of quality control and providing the Agency with reasonable

assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively and complied with in practice.

(e) Internal Review Directorate (IRD). The IRD investigates alleged misconduct by DCAA employees and alleged deficiencies in DCAA policies, programs and operations. Responsible for evaluating and ensuring DCAA compliance with laws, regulations, policies and standards relating to detection of fraud, waste, abuse and mismanagement in DCAA programs and operations. This includes: maintaining an internal website for anonymous reporting of allegations of misconduct against Agency employees or workplace issues; conducting prompt, impartial investigations of internal complaints and of any forwarded from the DoD IG Hotline; resolving the complaints or elevating/referring them to proper authorities; ensuring impartial, fair and objective treatment of employees in the consideration of all concerns.

b. Regional Offices and Field Detachment

(1) Office of the Regional Director. DCAA presently has five Regional Directors who are individually responsible and accountable to the Director for planning, managing, and accomplishing the Agency's mission in assigned geographical areas. This includes directing the overall management of DCAA personnel and resources assigned to the individual Regional Offices and to the various Field Audit Offices (FAOs) and suboffices within the regions. Each Regional Director's staff includes a Deputy Regional Director, several Regional Audit Managers, a Special Programs Manager, a Resources Manager, and a Special Assistant to the Regional Director.

(2) Director, Field Detachment. The Director of DCAA's Field Detachment is responsible and accountable for the overall planning, management, and execution of worldwide DCAA contract audits of compartmented programs and for managing all of the resources and staff assigned to the Detachment. The Director's staff includes a Deputy Detachment Director, several Detachment Audit Managers, and a Special Assistant to the Field Detachment Director.

(3) Field Audit Offices (FAOs).

(a) Resident Offices. Are established at contractor facilities whenever the amount of audit workload justifies the assignment of a permanent staff of auditors and support elements. Resident Offices, which can be made up of several suboffices of components within the same company, are responsible and accountable for planning and executing a comprehensive, integrated audit program to carry out DCAA's audit mission. Resident offices are responsible for implementing a sound quality control program based on Headquarters and regional directives.

(b) Branch Offices. Are established to plan and execute a comprehensive audit program to carry out DCAA's audit mission at those contractor locations, within a general geographical area, which individually do not have sufficient workload to justify establishing a Resident Office. Branch Offices are generally organized to cover their smaller contractors from one central office on a mobile basis. Larger contractors are often covered from suboffices. Branch offices are responsible for implementing a sound quality control program based on Headquarters and regional directives.

c. Executive Steering Committee

The Executive Steering Committee (ESC) includes the Director, Deputy Director, Assistant Directors, General Counsel, Regional Directors, and Director, Field Detachment. The Executive Officer and Special Assistant for Quality Management provide staff support to the ESC. The ESC is responsible for:

- establishing the vision and strategic goals for the Agency and monitoring attainment of the goals,
- providing overall management and direction for the Agency, and
- identifying, evaluating, and making recommendations on Agency-wide policy and improvement projects.

d. Participative Work Teams

Participative Work Teams (PWTs) are in place at all DCAA field offices. Audit PWT members include the supervisory auditor and his/her assigned auditors. PWTs hold regularly scheduled meetings to share information and complete PWT-related responsibilities.

### 2-S102.3 Approach

Auditing in accordance with generally accepted government auditing standards is the principal work of the Agency. To promote the quality accomplishment of this work, DCAA auditors are initially guided to take steps to develop a thorough knowledge of the contractual matters and circumstances affecting their audits. These steps entail:

- Developing an “intelligence base” on a contractor’s operations and contracting environment in order to assess the events and conditions that affect the contractor actions and the Government’s cost impact.
- Identifying the audit universe and documenting interrelationships between a contractor’s organization and operations so that all significant auditable activities which affect the costs of Government contracts are identified.
- Accurately assessing the strengths and weaknesses of a contractor’s internal controls, accounting and management systems, and methods of operation, in order to: (1) identify the relative risk in selecting or deferring a contractor system for audit evaluation in the current period; (2) evaluate the Government’s exposure to potential fraud, waste, and mismanagement; and (3) tailor audit programs for specific assignments. It is DCAA’s policy that each accounting or management system at major contractor segments that have significant flexibly-priced contract work be reviewed on a cyclical basis and the results of these reviews be recorded on an Internal Control Audit Planning Summary (ICAPS) form.
- Accomplishing certain basic, core audit requirements before rendering an opinion on contract costs incurred and before relying on incurred costs in any other review or evaluation. If no weaknesses are disclosed, the satisfaction of these core requirements provides a basic level of assurance that a contractor’s incurred cost representations are reliable. If weaknesses are disclosed, audit procedures must be extended accordingly.
- Determining that contractor systems for estimating prices are adequate and in compliance with applicable regulations.
- Assuring that all laws, regulations, and authoritative technical guidance for the accounting and auditing professions (including those issued by DCAA) are followed.
- Continually assessing progress on individual assignments and program areas in order to react timely and positively to changed conditions within the industry, acquisition, and audit environments. DCAA, for example, continually assesses the increased use of information technology and its impact on Agency audits.

## 2-S103 Elements of DCAA'S Quality Control System

### 2-S103.1 Independence and Ethical Requirements

#### a. Objective.

To establish policies and procedures on independence, legal and ethical requirements to provide reasonable assurance that the audit organization and its personnel maintain independence and comply with applicable legal and ethical requirements in GAGAS 3.88.

#### b. Policies and Procedures.

##### (1) General Requirements.

(a) DCAA employees at all organizational levels must adhere to the requirements on independence as stated in the GAGAS general standards, DCAA Instructions, Contract Audit Manual (CAM), and Personnel Management Manual (PMM). CAM 2-203 incorporates guidance on the GAGAS general standard pertaining to independence and the following quality control policies and procedures, which prescribe the DCAA auditor's and internal specialist's responsibilities for independence when performing work on audits.

(b) It is DCAA's policy that auditors and internal specialists must immediately notify their supervisor in writing, if they believe they have or may have a threat to independence of mind or in appearance. The supervisor should take action to resolve the identified threat or potential impairment in a timely manner.

(c) No auditor or internal specialist with a significant threat to independence will be permitted to work on any assignment affected by the significant threat. In these cases, employees may be reassigned or rotated without change in grade to assure independence.

(d) DCAA employees are always expected to act professionally, objectively and without bias when performing audits and dealing with contractor personnel. DCAA management recognizes that disagreements between contractors and auditors over audit issues and the conduct of audits often occur (e.g., regarding access to records) and that such disagreements are not an indicator of potential independence impairment (e.g., bias). However, DCAA management should promptly investigate credible complaints regarding inappropriate behavior toward contractor representatives that would indicate a lack of audit objectivity. The resolution of the complaint should be documented.

##### (2) Mandatory Annual Training and Evaluation of Independence.

All audit staff and internal specialists (e.g. DL attorney-advisors who support audits, OTST industrial engineers, and operations research specialists) must complete mandatory independence training upon entering employment with the Agency and annually thereafter. As part of completing the independence training, all audit staff and internal specialists must acknowledge and confirm that he or she:

(a) Completed the independence training including the reading requirements listed in the introduction.

(b) Has read and understands GAGAS Sections 3.02 through 3.26 pertaining to independence.

(c) Has used the GAGAS conceptual framework approach to independence to evaluate threats to his or her independence in relation to the list of contractors under the cognizance of his or her assigned office, as of the date of the training.

(d) Has, if appropriate, informed his or her supervisor in writing using the document titled "Documentation of GAGAS Independence Threat" of any independence threats identified because of the evaluation and will discuss the issue with his or her supervisor to determine if the threat is significant and requires application of safeguards.

(e) Will re-evaluate his or her independence upon assignment to an audit, and if no threats are identified, complete the Audit Specific Independence Workpaper or inform his or her supervisor in writing using the document titled "Documentation of GAGAS Independence Threat" of GAGAS threats to independence identified.

(f) Will re-evaluate his or her independence when facts and circumstances change will inform his or her supervisor in writing using the document titled "Documentation of GAGAS Independence Threat" immediately upon identifying GAGAS independence threats and will discuss the issue with his or her supervisor to determine if the threat is significant and requires application of safeguards.

(3) Re-evaluation of Independence.

An auditor or internal specialist should re-evaluate his or her independence upon assignment to an audit and prior to performing any work on the audit when his or her personal situation changes (e.g., marital status changes, spouse changes employer) or upon temporary or permanent reassignment to another office. If the change in circumstances creates threats that may impair independence in relation to the assigned audit, in-process audits, or future audits he or she should disclose this to his or her supervisor in writing by executing Section I of the "Documentation of GAGAS Independence Threat" document. In these cases, the auditor or internal specialist will temporarily cease work on any affected assignment until a determination is made regarding the significance of the threat. If the reevaluation upon assignment to an audit did not identify any independence threats, the auditor or internal specialist should sign the Audit Specific Independence Determination workpaper documenting his or her independence in relation to performing the audit. The APPS delivers the Audit Specific Independence Determination in the audit assignment working paper packages, and it is available on the intranet as an Admin document on the Audit Programs, Audit Report Shells, and Other Audit Guidance webpage.

(4) Actions taken by Supervisor.

The supervisor will take action to resolve any identified independence threats in a timely manner. The actions taken by the supervisor to address identified threats to independence will vary depending on whether identification of the threat or potential independence impairment occurred upon completion of the training, before the performance of work on the audit, during the performance of the audit or after report issuance.

(a) Upon Completion of Training or Before Performance of Audit Work. If informed of the threat, upon completion of the training or prior to the individual performing work on the audit, the supervisor should review Section I of the "Documentation of GAGAS Independence Threat" document signed and submitted by the auditor or internal specialist using the following procedures:

(i) Discuss the identified threat with the auditor or internal specialist, evaluate the significance of the threat, and document the results of the evaluation and the rationale for the conclusions reached in Section II of the "Documentation of GAGAS Independence Threat" document

(ii) If application of safeguards is necessary, document the safeguards applied to eliminate or reduce the threat to an acceptable level and explain why the

safeguard is effective in Section III of the “Documentation of GAGAS Independence Threat” document.

(iii) If it is determined, the auditor or internal specialist needs to disassociate him or herself from the audit, or from audits of the contractor, the file documentation should include a copy of the employees disqualification letter.

(iv) Digitally sign the “Documentation of GAGAS Independence Threat” document for Sections II and III.

(b) During the Performance of the Audit. If informed of a threat to independence during the audit the supervisor should take the following actions:

(i) Immediately notify DCAA Headquarters, PAS of the issue through the regional office.

(ii) Ensure the auditor or internal specialist temporarily ceases working on any affected audits pending a determination of the significance of the threat.

(iii) Follow the procedures in paragraph (4a) Mandatory Annual Training and Evaluation of Independence, to document and evaluate the threat and, if the threat is significant, document the safeguards applied.

(iv) If the threat is significant, assess the impact on the work already performed on the affected in-process audits and determine what actions are necessary to ensure the audits comply with GAGAS.

(v) Document the impact assessment, including the rationale for the conclusions.

(vi) Coordinate the impact assessment and any other actions to be taken regarding the in-process audits with DCAA Headquarters (PAS) through the regional office.

(c) After Report Issuance. If a threat to independence is identified after issuance of the audit report, GAGAS 3.26 requires an evaluation of the threats impact on the audit and on GAGAS compliance. If it is determined the threat was significant, the standards require the auditor provide written notice to the parties to whom the report was distributed and rescind the report. This will ensure the report users are not relying upon audit conclusions that may be impacted by the significant threat to independence. In addition, auditors are required by the standards to perform an assessment to determine if additional audit work is necessary to reissue the audit report, including any revised findings or reissue the original report if the additional audit work does not result in a change in findings or conclusions. When a threat to independence is identified after report issuance, the supervisor should:

(i) Immediately notify DCAA Headquarters, PAS of the issue through the regional office.

(ii) Evaluate the threat, using the GAGAS conceptual framework and document the evaluation including the rationale for the conclusions reached.

(iii) If the threat is significant, draft a written notice to the parties to whom the report was distributed. The written notice should indicate a significant threat to independence existed during the performance of the audit. In addition, the written notice should explain the report is being rescinded. The written notice should include all pertinent information including that an assessment is being conducted to determine the impact on the audit and whether it will be necessary to conduct additional audit work to reissue the report.

(iv) Coordinate the notice with DCAA Headquarters, PAS through the regional office before making any notifications to the report recipients.

(v) Perform the assessment of the impact the threat had on the audit report and determine what additional audit work is necessary to reissue the audit. Document the assessment including the rationale for the conclusions, and a description of the additional audit work to be performed.

(vi) Coordinate the impact assessment with DCAA Headquarters PAS through the regional office.

(vii) Upon completion of the additional audit work, reissue the report, including any revised findings or conclusion or reissue the original report if the addition audit work did not change the findings.

(5) Ethical Requirements.

GAGAS also requires all auditors and internal specialists be aware of and comply with applicable Government ethics laws and regulations. The standards of conduct for DCAA employees are set forth in the provisions of DoD Directive 5500.7, "Standards of Conduct," and DoD Regulation 5500.7R, "Joint Ethics Regulation". In a particular case, if GAGAS independence or the ethic requirements are more restrictive than the other is, the auditor or internal specialist must follow the more restrictive rule.

(6) Seeking Advice.

An auditor or internal specialist who thinks he or she may have a threat to independence of mind or in appearance that would be significant and create an impairment should inform his or her supervisor in writing and discuss it with the supervisor promptly. When an independence or ethics question cannot be answered at the local level, the field audit office should provide the facts and circumstances, including its evaluation of the issue, to the regional office and request a determination from the regional office. If the regional office is uncertain, it should forward the facts and circumstances and the regional analysis of the issue to Headquarters. Since most independence issues also involve ethics, send the request to the Designated Agency Ethics Official or Alternative Designated Agency Official at DCAA's General Counsel (DL). DL will obtain input from Policy on GAGAS independence issues and prepare a consolidated response to all questions that involve both GAGAS and ethics concerns.

(7) Compliance Requirements.

DCAA auditors are required to comply with the preceding policies and procedures. Failure to do so may result in disciplinary action as appropriate.

## 2-S103.2 Personnel Management

a. Objective.

To provide reasonable assurance that:

- those hired possess the appropriate characteristics to enable them to perform competently;
- work is assigned to auditors having the degree of technical training and proficiency required in the circumstances;
- auditors participate in continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned and satisfy the GAGAS continuing professional education requirements; and
- personnel selected for advancement have the qualifications necessary to fulfill the responsibilities of the position they will assume.

b. Personnel Hiring Policies and Procedures.

(1) General. DCAA's policy is to make use of all available resources to assure that the Agency is fully staffed with qualified and competent auditor and administrative personnel. Recruiters must be carefully selected for their ability to represent the Agency effectively and to carry out this policy. The procedural guidance and specific responsibilities for implementing DCAA's recruitment program are contained in PMM, Chapter 11. This guidance covers the candidate sources and criteria for source selection, the college recruitment program, recruitment for intermediate- and senior-level positions, and candidate selection procedures.

(2) Qualifications. The Office of Personnel Management (OPM) establishes the required qualifications for Accountant and Auditor positions, GS-5 through 12. Qualifications for DCAA's administrative positions are found in the OPM Qualification Standards Handbook X-118 governing the particular occupational series.

(3) Informing Applicants and New Hires. During orientations conducted by the Personnel Office and FAO management, applicants and new hires are informed of Agency policies and procedures relevant to them. A recruitment brochure is also available to any interested person or college recruitment office.

(4) Employee Retention. As an extension of the recruitment process, DCAA invokes a probationary period. If, during this period, an employee is determined to lack the skills and character traits necessary for satisfactory performance as a career employee, his or her appointment will be terminated. Details on completing an Auditor Probationary Appraisal Report and the procedures relating to actions required by supervisors of new employees in the probationary period are covered in PMM, Chapter 19.

c. Personnel Assignment Policies and Procedures.

(1) General. Headquarters is responsible for providing the strong, central direction necessary for development and maintenance of a competent, professional staff and for effective utilization of this staff. Staffing positions are established and personnel are assigned at each organizational level to provide an optimum balance among mission needs, economy and efficiency of operations, and effective employee utilization. The Agency's personnel policies and procedures relating to position classification and position management are contained in PMM, Chapter 6. These policies and procedures are compatible with and fully support all affirmative social action programs. Refer to the preceding section on Organization for the general responsibilities of all principal DCAA organizational elements.

(2) Staff Qualifications. DCAA auditors and specialists (see Consultation below) must collectively have the skills necessary to accomplish all aspects of DCAA's audit mission. This requires detailed knowledge of:

- accounting and auditing theory, principles, procedures, and practices;
- organizations and contracts subject to audit;
- Government contracting policies and regulations; and
- management principles and skills.

Update and maintenance of the required skills is accomplished through DCAA's continuing education program (see Professional Development below).

(3) Staff Requirements and Distribution. DCAA's staff requirements are determined based on estimates of the workload and the time required to perform this work in accordance with generally accepted government auditing standards. Appropriate consideration in calculating these estimates must be given to such factors as

Government financial risk and vulnerability to fraud, waste, and abuse. Guidance for determining staffing requirements is provided annually through issuance of a Headquarters Planning and Staff Allocation Document (PSAD). This memorandum contains specific Agency direction for determining staffing requirements for the coming year.

The distribution of available personnel within DCAA is based on an evaluation of total Agency workload and priorities, and is made in consonance with the respective workloads of the five DCAA Regions, the Field Detachment, and Headquarters. Regional offices make distributions to Field Audit Offices (FAOs). A DCAA office is established when sufficient workload exists to justify a separate audit unit without unnecessarily duplicating administrative support requirements (see Organization).

The general guidelines used by DCAA for organizing staff, programming audits, scheduling performance of audit segments, and analyzing progress are contained in the Audit Planning Guide, available on the Intranet, which covers management of mobile audit workload and management of resident audit offices. Detailed programming objectives and guidance are set forth in the annual PSAD.

(4) FAO Assignments. The Field Audit Office or FAO is DCAA's base level organizational unit responsible for providing financial services and planning and performing contract audits for the DoD and other Government agencies. Accordingly, FAO managers have primary responsibility for the assignment of field office personnel while audit supervisors (see Supervision below), reporting to the FAO managers, generally direct the actual planning and performance of the individual audits.

The FAO supervisors, together with the FAO managers, are responsible for considering and weighing many variables and factors when assigning personnel. They must ensure the auditor possesses the necessary knowledge, skills, and abilities to perform the audit. They must also consider the technical difficulty, timing requirements, specialized expertise needed, and availability of personnel for each assignment. Under the direction of the supervisory auditor, the GS-13 Technical Specialists assigned to an FAO are responsible for the technical management and performance of the most complex audits in their specific program areas. Examples of these program areas are the Cost Accounting Standards, post award audits, terminations, claims, incurred costs, internal controls, compensation, universities and not-for-profits, and financial capability.

(5) Reassignment/Rotation. Employees are reassigned to different positions and locations as necessary to accomplish the Agency's mission. In fact, the Agency encourages employees to be mobile in the interest of broadening their experiences and increasing their qualifications. Specific procedures covering employee reassignment/rotation to satisfy Agency objectives are contained in PMM, Chapter 37.

d. Professional Development Policies and Procedures.

(1) General Guidelines & Requirements. It is DCAA's policy to systematically plan for and provide all of the training and development necessary for its auditors to:

- meet the GAGAS continuing professional education requirements,
- maximize their performance proficiency, and
- assure they remain current in the contract audit environment.

Individual organizational elements are responsible for establishing adequate plans and controls to ensure that all training and employee development activities are

accomplished economically, effectively, and on a timely basis, in consonance with the Agency's training and development program. This program encompasses:

- on-the-job training and skill development through carefully planned and progressively more complex employee assignments;
- formal training, including courses given by the Defense Contract Audit Institute (DCAI);
- self-development courses, developed or approved by DCAA personnel and administered by the Regions or DCAI;
- professional continuing education programs;
- attendance at short-term training courses on specific subjects offered by other sources; and
- self-development through attaining professional certification (e.g., Certified Public Accountant) and advanced degrees (including the Director's Fellowship Program in Management).

Specific procedures and responsibilities for carrying out the Agency's professional development program at all organizational levels are contained in the following PMM chapters:

Chapter 16	Career Management Program
Chapter 17	Performance Management System
Chapter 21	Training and Development
Chapter 30	Professional Activities Outside DCAA

PMM, Chapter 21 presents DCAA's Master Training and Development Plan for Auditors. This plan identifies the formal technical and management training, by type and course, which is essential or desirable for progression from one audit career level to another within DCAA.

The knowledge and skills that are required by contract auditors at various grade levels to effectively perform their assigned tasks are detailed in Chapters 16 and 17 of the PMM. These chapters also provide guidance on assessing individual performance and identifying individual training and education needs. As an integral part of its overall training and development program, DCAA also requires that specific evaluations be performed to assess the extent to which training sources are achieving stated objectives.

(2) Defense Contract Audit Institute (DCAI). The DCAI is responsible for developing the Agency's training program and courses. Courses provided at the Institute are designed and periodically updated to enable DCAA's auditors and managers to gain the knowledge and skills they need to perform their assigned tasks in carrying out DCAA's audit mission. The courses are also designed to improve performance weaknesses and to prepare employees for higher responsibilities.

(3) Specialization. Training needs are continuously reviewed and updated to meet present and anticipated Agency needs in specialized areas such as information systems and cost accounting for pensions and insurance. This specialized training is accomplished through the same basic training sources described in the General paragraph above, or derived from working with Agency specialists from Headquarters, Regional Offices, or DCAA's Technical Support Branch (see Consultation).

(4) On-the-job Training. This form of training is an integral part of the Agency's overall training and development program and is one of the most important responsibilities

of all DCAA supervisors. It provides employees with the opportunity to participate in all types of audit assignments at progressively higher levels of complexity and in different contract audit environments.

e. Advancement Policies and Procedures.

(1) Required Qualifications. The qualifications necessary for the various levels of auditor responsibility within DCAA can be stated in terms of the progressive growth in an individual's technical competence and professional ability. This concept of career development is delineated in PMM Chapter 16. The accounting and auditing knowledge and skills that are essential for the contract auditor at various grade levels to effectively perform the assigned tasks are stated in Chapter 16, appendix B, and Chapter 17, appendix D, of the manual.

(2) Criteria for Evaluating Performance. The performance of most DCAA personnel is evaluated in accordance with Office of Personnel Management (OPM) regulations. In many instances, these OPM regulations have been implemented by DoD directives and instructions. The objectives of DCAA's performance appraisal system include identifying the job elements of each position, establishing performance standards relative to the elements, informing employees of the job elements and the performance standards for their positions, and conducting a periodic formal review and discussion of the quality of each employee's work performance in relation to the established performance standards. These objectives and associated DCAA appraisal policies and procedures are presented in the PMM, Chapter 17.

(3) Advancement Decisions. Selections for promotions are made from among the best qualified candidates, based solely on their relative knowledge, skills, and abilities. Advancement selections to auditor positions GM-13 and above are made in accordance with DCAA's Career Management Program policies (see below). Positions GS-12 and below are filled non-competitively (without using vacancy announcements) by career ladder promotions, as employees demonstrate their ability to perform higher level duties. Agency guidance on advancement decisions is contained in PMM, Chapter 36, Merit Promotion.

(4) Career Management and Career Boards. DCAA managers and supervisors at all organizational levels are responsible for aiding subordinates in defining career objectives and implementing career plans and for making advancement recommendations (or decisions, when authorized) regarding employees under their supervision. Employees, in turn, are encouraged to familiarize themselves with the operation of the merit promotion program, provide complete and accurate information needed for consideration under the merit promotion program, and periodically review and update their experience records and other personal data maintained by the Personnel Office. Individual careerists must further provide the initiative and energy necessary for development of the skills required in their career field and recognize the advantages of mobility to themselves and the Agency.

A DCAA Career Development Board (CDB) is established at Headquarters with responsibilities for providing policy guidance and monitoring DCAA's career management planning and programming activity. The CDB consists of senior Headquarters executives who:

- recommend for the Director's approval the establishment or revision of employee development activities which may be expected to improve the operation of the career management program and

- review lists of candidates for filling all auditor and administrative positions at grade GM-14 and above to determine those best qualified for referral to the Director, who is the selecting official.

Regional Directors are accountable for the effective functioning of their respective Region's career management programs and Career Management Boards (CMBs). Each CMB consists of senior regional managers who recommend any needed revisions in the program to the Regional Director and who periodically evaluate the region's career management programs.

### **2-S103.3 Acceptance of Engagements/Assignments**

a. Objective.

To provide reasonable assurance that:

- DCAA undertakes only those engagements/assignments that can be completed with professional competence,
- the risks associated with providing professional services in particular instances are appropriately considered, and
- an understanding is reached with the customer regarding the services to be performed.

b. Policies and Procedures.

(1) General Requirements. It is DCAA's mission to perform all necessary contract audits for DoD (and other agencies as appropriate) and provide accounting and financial advisory services regarding contracts and subcontracts to those responsible for procurement and contract administration. If a requested audit service appears to be outside the mission of DCAA, the request is referred to the Agency Director for a determination as to whether DCAA will perform the requested service. Only those engagements that can be completed with professional competence are undertaken by DCAA.

(2) Understanding the Services to be Performed. During the planning phase of an assignment, it is essential that auditors coordinate with the customer or contracting official to obtain an understanding of the:

- purpose of the audit;
- contractual, regulatory, or other factors pertinent to the review; and
- nature of the audit services to be performed.

Auditors should determine the scope of audit based on the overall risk.

### **2-S103.4 Engagement Performance**

a. Objective.

To provide reasonable assurance that work performed by personnel meets the applicable professional standards, regulatory requirements, and the Agency's standards of quality. Audit assignments must be adequately planned, performed, supervised, reviewed, documented, and communicated in accordance with the GAGAS.

b. Engagement Design & Execution Policies and Procedures.

(1) Planning of Field Work. Adequate planning requires that appropriate consideration be given to the assignment of personnel. Consideration should also be given to report format and content. Likewise, coordinating the audit with cognizant contractor and Government procurement representatives both prior to and during the audit is

important. Although aspects of audit planning are presented throughout CAM, Chapter 3 specifically covers this critical element of quality control.

In planning and managing audits, regions and FAOs are directed to:

- ensure that quality performance is emphasized and
- implement the total audit concept technique (TACT).

While the techniques of TACT are geared to audits of major contractors, the TACT principle (managing audit activities on the basis of an integrated totality) applies equally to audits of smaller contractors. Certain TACT techniques are required and performed annually as part of DCAA's planning process. These include use of the internal control audit planning summary for major contractors and the internal control questionnaire for other contractors.

(2) Performance of Field Work. Every auditor assumes the duty to exercise professional judgment in the performance of his/her audits. Professional judgment requires auditors to perform their audits in accordance with generally accepted government auditing standards (GAGAS). Auditors should ensure that the nature, timing and extent of audit procedures performed are consistent with the risk assessments made and audit plan established. The CAM provides detailed audit guidance for the different audits/procedures performed.

(3) Supervision of Field Work. Supervisors are responsible for assuring that the necessary auditing procedures and tests are properly designed and systematically laid out so that they can be understood by the assigned audit staff. The extent of supervision and review required varies with the audit circumstances and depends on such factors as complexity of the work, the qualifications of the persons performing the work, and the extent of consultation available and used. The level of detail in a supervisor's instructions must be tailored to the auditor's experience, so that all elements necessary to performing a quality audit are addressed. Sufficient care must be exercised in supervising auditors and in reviewing their work throughout the audit. Findings and audit exceptions should be clearly described and well supported, and recommendations should be responsible and appropriate to the conditions described. Although aspects of audit supervision are presented throughout CAM, Section 2-302.2 specifically covers this critical element of quality control.

(4) Review of Working Papers and Reports. Supervisory review of working papers and reports is required to ensure that:

- the auditor conforms to auditing standards,
- audit programs are followed unless deviation is justified,
- the working papers conform to standards and adequately support the reported audit findings,
- the auditor accomplishes the audit objectives,
- the report is prepared in accordance with CAM, and
- the needs of the customer are understood and considered.

Documentation of supervisory reviews must be prepared and retained. A technical specialist or GS-12 senior auditor who has been properly delegated to act for a GS-13 supervisory auditor has the same authority as the supervisor to approve/initial-off on all audit working papers and final draft report, unless otherwise prohibited by the supervisor or FAO manager. Copies of delegations of authority must be maintained in the FAO permanent files under file code 205.9, Delegations of Authority.

Supervisors must assure that each auditor is fully aware of the GAGAS auditing and reporting requirements implemented in CAM. FAO supervisors are also responsible, along with their FAO and regional managers, for implementing all Headquarters policy guidance memorandums. Headquarters updates pro forma audit programs and reports as new policy guidance is issued. Audit programs are expected to be tailored to the specific assignment and approved by the supervisor.

The full performance level for DCAA auditors is the GS-12 senior auditor position. Experienced GS-12s may be called upon to give onsite work direction to trainees as long as it does not preempt the supervisor's responsibility or unduly interfere or prevent the GS-12 from the timely accomplishment of his/her principal work. Some GS-12s may be asked to furnish advice and instructions on specific audit programs, tasks, and techniques; plan and review individual work assignments within the scope of the total audit assignment; maintain the status and progress of work assignments; and provide on-the-job training to trainees.

(5) Documentation of Audit Performance. The auditor's work should be documented and retained in the form of working papers. Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain that the evidence supports the auditor's significant conclusions and judgments. The auditor should obtain sufficient, appropriate and relevant evidence to support a reasonable basis for his/her conclusions. CAM Section 4-400 contains detailed guidance for the preparation, format, contents and retention of audit working papers.

(6) Communication of Audit Results. Audit reports are the principal means of communicating the audit results to our customers. Auditors must exercise professional judgment in preparing, reviewing, and processing reports to provide reasonable assurance that the reports are accurate, complete, clear, and prepared in accordance with the GAGAS reporting standards. CAM Chapter 10 contains detailed guidance for the preparation and distribution of DCAA audit reports. FAO managers should review and sign significant or sensitive reports as prescribed in DCAA Regulation 5600.1. This Regulation also establishes the requirements for delegating supervisors authority for signing certain audit reports and related audit documents.

c. Consultation Policies and Procedures.

The auditor is responsible for obtaining sufficient evidence to express an opinion. Since the advice of technical specialists can constitute a significant part of this evidence, auditors must first recognize when areas of an assignment extend beyond their expertise and then obtain assistance from individuals who have the skills needed to evaluate those areas. CAM Appendix D contains detailed guidance on assessing the need for technical specialist assistance, requesting technical assistance and reporting the use of the assistance. When specialists are used, the auditor is responsible for satisfying himself or herself as to their professional qualifications and reputation by inquiry or other procedures. Refer to AICPA Standards of Field Work, "Using the Work of a Specialist," for this and other considerations in determining the need for consultation.

(1) Sources for Consultation. DCAA auditors may consult with either specialists in a particular field or auditors with specialized experience and training. This includes personnel with specialized technical skills who are assigned to Government procurement activities and to attorneys assigned to the Defense Legal Services Agency. Other sources include DCAA employees assigned to Headquarters, Regional Offices, and Field Audit Offices (FAOs). An example of a Headquarters source is the Technical Support Branch

(see below), whose employees have specialized experience and training in such areas as information systems, computer assisted audit techniques, and quantitative methods.

To further support the audit mission, reference libraries with assorted technical and professional publications and other material are maintained in accordance with DCAAR 5000.1. New audit approaches, guidance, and techniques are investigated, developed, and implemented, as required, through research and evaluation conducted by Headquarters and Regional Offices.

(2) Technical Support Branch (OTST). The OTST has been specifically established under the DCAA Assistant Director, Operations, to operate as a focal point for applications research and development activities, and as a source of expertise which is available to field elements engaged in both traditional audits and nontraditional audits. Staffed by computer specialists, engineers, CPAs, and other professionals having the expertise needed to support DCAA's mission, the OTST provides assistance in the areas of advanced information systems, computer assisted audit techniques (CAAT), operations audits, and special programs.

(3) Requests for Consultation. DCAA's goal is to minimize the number of reports in which auditors have to express a qualified audit opinion because of a lack of specialized knowledge or skills. DCAA's evaluations of price proposals frequently require specialized technical assistance from the cognizant procurement or contract administration activities. Therefore, with few exceptions, requests for this type of assistance are routinely handled. That is, when determined necessary, they are made orally or in writing to the cognizant servicing activity (9-103.1). With regard to requests for technical assistance to perform an incurred cost audit or operations audit, it is DCAA policy that the auditor will request the assistance from the contract administration activity responsible for the contractor being audited (2-202a). Requests for specialized assistance from Regional Offices, Headquarters, or from the Defense Legal Services Agency are accomplished through Regional Office channels.

(4) Results of Consultation. The results of a technical review performed by a specialist are expected to be sufficiently detailed for the auditor to satisfy his or her reporting requirements and to include in a final consolidated audit report. To ensure that the results are correctly reported, the auditor must:

- examine them in light of all known facts,
- understand the methods and assumptions used by the technical specialist, and
- attain assurance that the technical findings are appropriately applied in relation to the contractor's financial representations.

Where the results do not appear to be correct or complete, the situation is discussed with the specialist, and any remaining significant differences of opinion are elevated to the Regional Office. Issues that cannot be resolved by the Regions are forwarded to Headquarters in a timely manner. Especially difficult accounting or cost principle issues that cannot be answered using existing regulations and reference sources are referred by Headquarters to the responsible authoritative body for clarification or other appropriate action. All appropriate files documenting the resolution of any significant differences of opinion are required to be maintained for reference and research purposes.

## 2-S103.5 Monitoring

### a. Objective.

To provide reasonable assurance that the policies and procedures established by DCAA for each of the elements of quality control described above are suitably designed and are being effectively applied. Monitoring involves an ongoing consideration and evaluation of the:

- relevance and adequacy of DCAA's policies and procedures;
- appropriateness of DCAA's guidance materials;
- effectiveness of professional development activities; and
- compliance with DCAA's policies and procedures, including appropriate follow-up of quality related issues.

### b. Policies and Procedures.

(1) General. Direct responsibility for quality control in all audit and resource management functions is vested in the line and staff managers and supervisors at all levels of DCAA. As stated above, the Executive Officer is responsible for preparing the Director's annual statement certifying that DCAA's system of internal accounting and administrative control provides a reasonable assurance that management controls are in place and operating effectively as required under the Federal Managers' Financial Integrity Act (FMFIA). As reported through the FMFIA process, the Executive Officer monitors tests of critical management controls performed by others and advises the Director and Deputy Director on any sensitive matters disclosed by quality or management control reviews. In addition, the Special Assistants to the Regional Director coordinate periodic management control reviews in accordance with FMFIA.

(2) Relevance and Adequacy of DCAA's Policies and Procedures. Quality control review planning considers the universe of all audit and resource management functions at all organizational levels. Areas for review are prioritized on the basis of periodic full-scale vulnerability assessments, supplemented by data monitoring at the Headquarters level and continual input of any other indicators from any source. The assessments consider the coverage and results of external audits and oversight reviews such as those by the Government Accountability Office; the Department of Defense; Office of the Inspector General; Office of Personnel Management; the Information Security Oversight Office; the Office of the Secretary of Defense; and the Office of Government Ethics; to avoid duplication. Depending on its nature, the area to be reviewed may be covered by:

- onsite visits to lower-tier offices by Headquarters or Regional Office program managers or functional specialists;
- fact-finding by cognizant line or functional staff managers or supervisors using such tools as centrally directed survey instruments and checklists for gauging audit performance;
- Headquarters desk reviews of sample transaction/event packages called in from Field Audit Offices (for example, audit reports or working papers);
- onsite review of internal systems by DCAA specialists who normally support our contract audit function, such as IT staff; or
- review by peers from outside the organization being reviewed, including outside DCAA if required.

The quality control program provides timely feedback to all levels of management on the state of compliance with the Agency's objectives, policies, and procedures. It also provides

appropriate focal points for tracking the implementation of corrective action plans established by management to address issues of noncompliance disclosed by external reviews or internal quality control activities. All significant review results and associated plans affecting Agency-wide operations are reported to the Agency's Executive Steering Committee (see Organization above).

(3) Appropriateness of DCAA's Guidance Materials. DCAA produces and maintains a substantial amount of audit guidance, audit management guidance, and administrative guidance in the form of regulations, instructions, manuals, pamphlets, and memoranda. DCAA's guidance publications/issuances are routinely posted to and readily accessible on the Agency's Intranet. DCAA's Headquarters, regional, and Field Detachment staffs continually assess the need for new or revised guidance. For example, the Publications and Systems Division (PPS) of the Headquarters Policy and Plans Directorate periodically posts changes to the Agency's online Contract Audit Manual and republishes a printed Manual on a semi-annual basis. On a continuous basis, PAS updates DCAA's standard audit programs, working papers, and shell audit reports. Guidance revisions arise from many sources, including the issuance of new professional standards, decisions of DCAA's Executive Steering Committee, input from Headquarters, regional and field personnel.

(4) Effectiveness of Professional Development Activities. The Defense Contract Audit Institute (DCAI) is responsible for managing the Agency's professional development and training program. The DCAI staff evaluates on an ongoing basis the effectiveness of the Agency's professional development program (For additional information on DCAI's monitoring procedures see the Professional Development section under the Personnel Management quality control element above).

(5) Compliance with GAGAS and DCAA's Audit Policies and Procedures and Follow-up of Quality Related Issues. Compliance is monitored on a daily basis by regional staff personnel, field audit office (FAO) management, and the members of the participative work teams at the individual FAOs. The QA organization within DCAA (see Organization above) assesses the state of auditor compliance on completed audit assignments. It does this by performing:

- QA-related review projects on both an Agency-wide and regional basis; and
- continuous rounds of internal reviews that follow the guidelines and use the checklists adapted from the President's Council on Integrity & Efficiency (PCIE) External Quality Review Guide.
- The objectives of the PCIE-based reviews are to:
- Evaluate the effectiveness of DCAA's quality control system as it relates to the selected audits and determine whether the FAOs and audits satisfactorily complied with the applicable GAGAS and Agency policies;
- Identify the Agency's audit policies, or elements thereof, that contribute to specific instances of noncompliant activity disclosed by the review;
- Identify the areas where improvements are needed in the level of FAO compliance with the GAGAS and DCAA's related audit policies; and
- Significantly facilitate the implementation of Agency-wide process improvements.

A key component of monitoring is timely and effective follow-up of action taken by DCAA's audit and policy management to address/correct quality related issues identified by other elements of DCAA's quality control system. Timely and effective follow-up often involves the need for new or enhanced Agency policies and procedures, as well as

the development and implementation of corrective action plans by Regional management (i.e. Regional Directors, Regional Audit Managers, FAO Managers, or Supervisors) to address specific issues or deficiencies. Headquarters Policy and Plans Directorate is responsible for revising Agency policies and procedures when inadequacies in guidance are identified. When deficiencies are identified in the level of field auditor compliance with policies and procedures or GAGAS, Regional management is responsible for developing appropriate corrective action plans to address the deficiencies/noncompliant practices. Regional management is also responsible for:

- assuring that the corrective actions are implemented in a timely and effective manner, and
- following-up on the actions taken on an “as needed” basis to assure that they achieve the intended results.

One of the tools available to regional management to monitor working paper compliance with GAGAS and Agency policy is the DCAA Quality Checklist for Review of Audit Working Papers. This checklist can be used for the purposes of auditor self-assessment, a peer review, or a supervisory review of the audit working papers. The checklist is maintained by Headquarters – PQA, and can be found in the APPS and on the DCAA Intranet.

**2-S104 Administration of DCAA'S Quality Control System**

## a. Objective.

To provide reasonable assurance that the Agency's quality control system achieves its objectives. In so doing, appropriate consideration must be given to the:

- assignment of quality control responsibilities,
- means by which quality control policies and procedures are communicated, and
- extent to which the Agency's policies and procedures and compliance therewith should be documented.

## b. Policies and Procedures.

(1) Assignment of Responsibilities. All quality control procedures discussed above are designed and maintained by the staff elements of DCAA's Headquarters, regions, or Field Detachment. All employees are responsible for complying with the procedures.

(2) Communication of Quality Control Policies and Procedures. The Agency's quality control policies and procedures are contained in various Agency publications, including the DCAA Charter, Instructions, Manuals, and other DCAA directives. Most Agency publications are contained on the DCAA intranet and are accessible to all auditors. The majority of the quality control procedures are contained in the CAM. The CAM is updated continuously and available to all personnel on the DCAA Intranet. It is printed semiannually and provided to all personnel.

(3) Documentation of DCAA's Quality Control Policies and Procedures. A strong, well-documented internal quality control system has been in place within DCAA since its inception. Key elements of the system are described throughout this manual and summarized in this section. The system is further documented in the Agency's charter, regulations, instructions, personnel management manual, etc. The Agency also documents its system of quality control for the Department of Defense, Inspector General (DoDIG) through completion of the form entitled (DCAA's) Audit Quality Control Policies and Procedures. The form is part of the President's Council on Integrity & Efficiency (PCIE) External Quality Control Review Guide.

The attention given to improving the Agency's quality system and its documentation over the years is evidence of the strength of the system. The Agency's implementation of the Federal Managers' Financial Integrity Act (FMFIA) and related DCAA internal management control system requirements (DCAA Regulation No. 5010.7) are key examples of the continuous improvement of the system and its documentation. FMFIA implementation, in particular, served to consolidate various elements of the system and restructure the system's documentation.

As noted under 2-S102.2.a.(1), the Executive Officer (DX) is responsible for drafting the Director's annual statement required by the Federal Managers' Financial Integrity Act (FMFIA). The statement documents that:

- The Director recognizes the importance of management controls,
- DCAA has conducted an annual evaluation of the Agency's system of accounting and administrative control, which covered the management controls within that system,
- The annual evaluation was conducted in a conscientious and thorough manner, and that

- The results of the annual evaluation show that the management controls are in place and operating effectively.

The broadly termed system of accounting and administrative control noted in the FMFIA statement encompasses DCAA's system of audit quality control. The enclosure supporting the annual statement documents in detail the audit quality control system and the monitoring and evaluation of that system.

(4) Documentation of Auditor Compliance with DCAA's Quality Control Policies and Procedures. As mentioned above, the enclosure supporting the annual FMFIA statement documents in detail the monitoring and evaluation of DCAA's audit quality control system. It covers the monitoring and evaluation done by regional management and staff personnel and by the management and personnel assigned to the various Headquarters elements. The Assistant Director for the Headquarters Policy and Plans Directorate has the greatest responsibility for:

- assuring that Agency auditors are performing audits in accordance with the GAGAS, and
- documenting the Directorate's work that provides the appropriate level of assurance.

The Policy Directorate fulfills its responsibilities through the work of its Divisions (see Organization above) and staff of program managers, and through the general management and oversight of DCAA's Quality Assurance (QA) function.

The management and oversight of the QA function and the documentation of the Agency's QA review efforts are accomplished through the Policy Directorate's Quality Assurance Division in the manner outlined above under Organization – Quality Assurance and Monitoring -- Compliance with GAGAS and DCAA's Audit Policies and Procedures. The documented results of the QA reviews are routinely provided to the Agency's Executive Steering Committee and to its external reviewers – the DoD Office of Inspector General.