

**CHAPTER 2**

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## CHAPTER 2

## 2-000 Auditing Standards

## 2-001 Scope of Chapter

a. The term "audit" is used to refer to a variety of types of evaluations of various types of data by a person other than the preparer of the data. There is no commonly accepted definition of precisely what constitutes an audit that can be assumed to apply to all cases in which the term is used. In order to be understood, the term "audit" must be accompanied by an explanation of the type of data being evaluated; of the auditing standards followed for data falling within the category of financial information; and if not otherwise implied by the standards, of the purpose and scope of work undertaken.

b. Auditing standards differ from audit procedures discussed elsewhere in CAM 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 undertaken.

c. Government Auditing Standards (GAS) directly incorporate all AICPA standards as they are issued, unless GAO excludes them by separate formal pronouncement. When the Yellow Book incorporates standards of the American Institute of Certified Public Accountants (AICPA) or other authoritative bodies, such as the Office of Management and Budget, these standards become Generally Accepted Government Auditing Standards (GAGAS). It is important to understand the various standards and how they affect DCAA audits. Generally the Yellow Book standards govern:

- (1) the quality of the audit performance, including audit planning and supervision,
- (2) the nature and extent of audit evidence to be obtained by means of auditing procedures, and
- (3) the nature and content of audit reports.

## 2-100 Section 1 --- Auditing Standards and DCAA Audits

## 2-101 Generally Accepted Government Auditing Standards (GAGAS)

a. By reference, DoD Instruction 7600.02, "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 President's Council on Integrity and Efficiency and the DoDIG. These standards are applicable to DCAA.

b. A major revision of the Yellow Book was issued in June 2003. A copy is included in each DCAA FAO library, and is available via a link on the DCAA intranet under DCAA Audit/Administrative Guidance or at the GAO web site, <http://www.gao.gov/govaud/ybk01.htm>. This is the fourth revision of the overall standards since they were first issued in 1972. The 2003 Yellow Book supersedes the 1994 revision, including amendments 1 through 3, and makes changes to the standards in the following areas:

- Redefining the types of audits and services covered by the standards, including an expansion of the definition of performance auditing and adding attestation as a separate type of audit.
- Providing consistency in field work and reporting requirements among all types of audits defined under the standards.
- Strengthening the standards and clarifying the language in areas that, by themselves, do not warrant a separate amendment to the standards.

Because of the breadth of the fourth revision to the overall standards, any new standards are applicable for financial audits and attestation engagements for periods ending on or

after January 1, 2004, and for performance audits beginning on or after January 1, 2004. The revision of the standards currently incorporates the field work and the reporting standards issued by the AICPA. The GAGAS general standards apply to financial audits, attestation engagements, and performance audits. The GAGAS general standards are similar to AICPA general standards; however, the GAGAS general standards include requirements for continuing professional education and a quality control and assurance program.

c. 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, as defined by their objectives that are covered by GAGAS, are classified as financial audits, attestations, or performance audits. While GAGAS classifies most Government contract audits as attestation audits, DCAA may also occasionally perform financial statement audits. In addition, DCAA routinely performs economy and efficiency audits (operations audits) that fall under the performance audit classification. The GAGAS for each classification are to be followed in DCAA audits, as appropriate.

d. Financial statement audits are performed under the AICPA Generally Accepted Auditing Standards (GAAS) for field work and reporting, as well as the related AICPA Statements on Auditing Standards (SAS). To meet the needs of users of Government audits, GAGAS also prescribe requirements in addition to those provided by the AICPA for the same type of work. The supplemental Government fieldwork standards applicable to financial statement audits require auditors to:

- Communicate information to the appropriate officials of the organization audited, and individuals contracting for or requesting the audit services (GAGAS 4.06 through 4.13).
- Consider the results of previous audits and attestation engagements; and follow-up on known significant findings and recommendations from previous audits (GAGAS 4.14 through 4.16).
- Design the audit to detect material misstatements resulting from violations of contract provisions or grant agreements and abuse (GAGAS 4.17 through 4.19).
- Pursue indications of fraud, illegal acts, violation of contract provisions, or abuse (GAGAS 4.20).
- Plan audit procedures to develop the elements of a finding to facilitate developing the auditors' report (GAGAS 4.21).
- Include sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from the audit documentation the evidence that supports significant judgments and conclusions (GAGAS 4.22 through 4.26).

e. Attestation Engagements. The AICPA issues Statements on Standards for Attestation Engagements (SSAEs) that interpret standards for field work and reporting on attestation engagements. Attestation engagements concern examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results. GAGAS prescribe general standards and additional field work and reporting standards beyond those provided by the AICPA for attestation engagements. The specific general, field work, and reporting standards applicable to attestation engagements are identified in GAGAS Chapter 6. The Government reporting standards for attestation audits require that reports:

- Follow applicable AICPA reporting standards (GAGAS 6.27).
- State that the audit was made in accordance with Generally Accepted Government Auditing Standards (GAGAS 6.29 through 6.31).
- Report deficiencies in internal control, all instances of fraud and illegal acts unless clearly inconsequential, violations of provisions of contracts or grant agreements and abuses that are material to the subject matter or assertion, and in certain instances report fraud, illegal acts, violation of provisions of contracts or grant agreements, and abuse directly to external parties other than the requestor (GAGAS 6.32 through 6.40).

- If the auditor's report discloses deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions (GAGAS 6.41 through 6.45).
- If privileged and confidential information is omitted from the report, state the nature of the information omitted and the requirement that makes the omission necessary (GAGAS 6.46 through 6.48).
- Submit reports to the appropriate officials of the organizations requiring or arranging for the audits, other officials with oversight authority, and the auditee (GAGAS 6.49 through 6.54).

DCAA has chosen to follow certain financial statement reporting standards in its attestation audit reports which require the auditor to either describe the scope of tests of compliance with laws and regulations and control risk assessments that impact the audit or refer to separate report(s) containing that information (GAGAS 5.08).

f. Performance audits are subject to the fieldwork standards in GAGAS Chapter 7 and reporting standards in GAGAS Chapter 8. Reporting standards include:

- Prepare audit reports communicating the results of each audit (GAGAS 8.02 through 8.06).
- Report the audit objectives, scope, and methodology (GAGAS 8.07 through 8.12).
- Report significant audit findings, and where applicable, auditors' conclusions (GAGAS 8.13 through 8.16).
- Report any significant deficiencies in internal control and all instances of fraud and illegal acts unless they are clearly inconsequential (GAGAS 8.17 through 8.26).
- Report recommendations for actions to correct problem areas and to improve operations (GAGAS 8.28 through 8.29).
- State that the audit was made in accordance with Generally Accepted Government Auditing Standards (GAGAS 8.30).
- Report the views of responsible officials (GAGAS 8.31 through 8.34).
- If privileged and confidential information is omitted from the report, state the nature of the information omitted and the requirement that makes the omission necessary (GAGAS 8.35 through 8.37).

g. 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 audit), and in the audit report shells appearing within APPS and on the DCAA Intranet.

## 2-102 Auditing Standards

a. Public Company Accounting Oversight Board (PCAOB). The 2003 Yellow Book currently incorporates the field work and reporting standards issued by the AICPA. 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 preparation and issuance of audit reports for publicly traded companies. As the PCAOB promulgates auditing standards for audits of these entities, the GAO and DCAA will closely monitor the actions of both standard-setting bodies and will issue clarifying guidance, as necessary, on the incorporation of future standards set by either standard-setting body.

b. AICPA. Generally Accepted Auditing Standards (GAAS) refer to the auditing standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). The 2003 Yellow Book currently incorporates the field work and reporting standards issued by the AICPA. In order to report that an audit was performed under GAAS, an auditor must be licensed by a state board of accountancy or, with limited exceptions, must be employed by a firm which is so licensed. DCAA is not

authorized to state that its audits have been performed under GAAS. As noted above, the Yellow Book incorporates the GAAS fieldwork and reporting standards in its guidance for financial statement audits and requires that the report state that it was performed in accordance with GAGAS.

c. The AICPA, through its Auditing Standards Board, has also issued an extensive series of interpretations of its standards (referred to as Statements on Auditing Standards (SAS)) which independent public accountants (IPAs) are expected to follow when performing financial audits of publicly traded companies that are not registered with the PCAOB. A codification of the SAS is in each DCAA field audit office library. New SAS are published in the Journal of Accountancy at the time of issuance, and the SAS are periodically recodified.

### **2-103 AICPA Attestation Standards**

a. As discussed in 2-101 above, the Yellow Book adopted many of the AICPA's Statements on Standards for Attestation Engagements (SSAEs) as appropriate guidance for performance of Government attestation audits.

b. An attest 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 very important to identify the assertion or subject matter being reported on. Ordinarily, the audit will report on an assertion, which may be certified (e.g., incurred cost proposal), or explicit (e.g., price proposals, certified or not). In some instances, the audit will report directly on a subject matter (e.g., an audit of internal controls relative to accounting and management systems).

c. The attestation standards define different levels of assurance in relation to the auditor's opinion or conclusions.

(1) An "examination" is the highest level of assurance, i.e., the audit objective is to gather sufficient evidence to restrict attestation risk to its lowest level, thereby supporting a positive opinion. In the contract audit environment, evaluations of complete submissions (price proposals, claims, and overhead rate proposals) that are not subject to scope limitations are "examinations." Additionally, the auditor may examine sufficient evidence to support a positive opinion for the audit of "parts of a proposal" while disclaiming an overall opinion (see 10-305).

(2) A "review" involves a moderate level of assurance, i.e., the work performed is less than an examination. The auditor accumulates sufficient evidence to restrict attestation risk to a moderate level, therefore, the auditor would not provide a positive opinion, but would give negative assurance based on the work performed. Auditors are precluded from giving negative assurance if:

(a) the auditor concludes that an examination cannot be performed because competent persons, under similar conditions, would not obtain consistent results;

(b) the evaluation expresses an opinion on internal controls;

(c) the evaluation expresses an opinion on compliance with laws and regulations; or

(d) the auditor is unable to perform the inquiry and analytical or other procedures he or she considers necessary to achieve the limited assurance contemplated by a review.

(3) Application of agreed-upon procedures--In an agreed-upon procedure engagement, an auditor is asked by the requestor to report on findings based on specific criteria identified by the user of the report. The requestor and auditor must agree on the scope of the audit. An agreed-upon procedures report does not provide positive or negative assurance. The audit report must disclaim an opinion (see 10-1000).

d. The attestation standards are a natural extension of the GAAS to attestation audits. They deal with the need for technical competence, independence in mental attitude, due professional care, adequate planning and supervision, sufficient evidence,

and appropriate reporting. The different performance levels give the auditor considerable flexibility to tailor the engagement to the needs of the report user.

e. The AICPA attempts to reserve the words "audit" and "auditor" to financial statement audits. The attestation standards convert the terminology above ("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 no longer refers to an evaluation affording the highest level of assurance interchangeably as an "examination" or an "audit." The AICPA terminology is appropriate when discussing the report to be issued on a specific engagement. DCAA will continue to use "audit" to apply to all work performed. DCAA will use specific terminology in the reporting language for audits requiring different levels of assurance (i.e., an examination, a review, or an application of agreed-upon procedures).

**2-104 Types of Attestations**

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

a. Positive assurance. In an attestation designed to provide the highest level of assurance on an assertion or on a subject matter (an examination) the auditor's objective is to accumulate 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 evaluation, the auditor should select procedures to assess inherent and control risk in order to restrict detection risk and attestation risk to an appropriately low level.

b. Negative assurance. In a limited assurance engagement (a review), the objective is to accumulate sufficient evidence to restrict attestation risk to a moderate level. Procedures performed are generally limited to inquiries and analytical procedures, rather than including search and verification procedures. When inquiry and analytical procedures:

- (1) cannot be performed, the auditor should substitute other procedures which will yield the desired level of assurance;
- (2) are deemed less efficient than other procedures, the auditor should choose the more efficient procedures;
- (3) yield evidence indicating that the assertion may be incomplete or inaccurate, the auditor should perform additional procedures.

c. Unqualified, qualified, and adverse findings. When an examination or review determines that the assertion is both complete and accurate, the report findings will be unqualified, giving positive assurance (if an examination was performed) or negative assurance (if a review was performed). When the audit determines that the assertion is incomplete or inaccurate, the auditor must issue either a qualified or adverse opinion, depending on the nature and pervasiveness of the audit exception(s) (If the attestation was a review, the same is true but the results of review are not referred to as an "opinion"). An adverse opinion states that the subject matter is not in conformity with the criteria, which includes the adequacy of the disclosure of material matters. Such an opinion is expressed when the auditor believes that departures from the criteria are so material and pervasive that the information presented is grossly misstated or misleading. An adverse opinion is still an opinion and, therefore, should be expressed only when the auditor has performed an audit of sufficient scope.

d. **Disclaimer of Opinion.** A disclaimer is issued when the examination or review has not been performed in sufficient scope to enable the auditor to form an opinion or provide negative assurance. The denial of an opinion (disclaimer of opinion) can arise only out of a lack of knowledge by the auditor because of scope limitations. A scope limitation refers to any unresolved problems the auditor has in complying with GAGAS, or in an agreed-upon procedures engagement, the specified procedures agreed to by the specified parties. When the auditor performs an application of agreed-upon procedures engagement (see 10-1000), the resulting report must disclaim an opinion because of the limitations on the audit scope. 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. Agreed-upon procedures must be established in advance of the field work. If, in the course of an examination or review, the auditor encounters a scope limitation (see 10-210.3), the evaluation may not be converted to an application of agreed-upon procedures merely to avoid disclosing the scope limitation. However, under certain circumstances, an examination or review may, before the completion of the audit, be converted to an agreed-upon procedure engagement. A request to change to an agreed-upon procedure 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, the auditor should consider:

- The possibility that certain procedures performed as part of an examination or review are not appropriate for inclusion in an agreed-upon procedures engagement.
- The reason given for the request.
- The additional effort required to complete the original engagement.
- 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 audit.

e. **Report Restrictions.** Restrictions on the use of an examination or a review 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. 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.

## **2-105 Performance Audits**

a. Under GAAS, an auditor is not required to evaluate, per se, the reasonableness of business operating decisions or matters of management and operational efficiency that directly impact operating costs. Generally Accepted Government Auditing Standards (GAGAS) for performance audits require the auditor to consider such matters. Performance audits encompass a wide variety of objectives, including objectives related to assessing program effectiveness and results; economy and efficiency; internal control; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information (GAGAS 2.09).

b. Economy and efficiency audits (GAGAS 2.10) are designed to determine:

- (1) whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently;
- (2) the causes of inefficiencies or uneconomical practices; and
- (3) whether the entity has complied with the laws and regulations concerning matters of economy and efficiency.

Operation type audits performed by DCAA fall into this category.

c. The objectives of program effectiveness and results audits address the value of a program and typically measure the extent to which a program is achieving its goals and objectives (GAGAS 2.10). Program audits are ordinarily performed by oversight agencies such as the DoDIG and the GAO.

d. Compliance audit objectives relate to compliance criteria established by laws, regulations, contract provisions, grant agreements, and other requirements that could affect the acquisition, protection, and use of the entity's resources and the quantity, quality, timeliness, and cost of services the entity produces and delivers (GAGAS 2.12).

e. Audits can also undertake work that provides a prospective focus or may provide guidance, best practice information, and information that cuts across program or organizational lines, or summary information on issues already studied or under study by an audit organization, such as analyzing budget proposals or identifying best practices for users in evaluating financial systems (GAGAS 2.13).

### **2-106 Nonaudit Services**

a. DCAA may provide nonaudit services, such as providing information or data without providing verification, analysis, or evaluation of the information or data. These "routine" types of interactions are normal between auditors and Government agencies that request DCAA services given the knowledge auditors gain of the contractor's operations. The DCAA auditor's role when performing a nonaudit service is that of a financial advisor. Nonaudit services are not covered by GAGAS and do not usually provide a basis for conclusions, recommendations, or opinions on the information or data. Generally, a report will not be issued for nonaudit services. However, any report or other correspondence regarding such services should not state that the nonaudit services were conducted in accordance with GAGAS. Additionally, consideration should be given to the potential for an impairment to independence by providing the nonaudit services (see 2-203.1).

b. Occasionally, DCAA may be requested to perform nonaudit services that GAGAS would not consider to be "routine." See 2-203.1e before agreeing to perform routine or non-routine nonaudit services.

## 2-200 Section 2 --- General Standards

### 2-201 Introduction

This section explains the "general standards" element of GAGAS for conducting audits. General standards relate to the competence of the staff, the audit organization's and the individual auditor's independence, the exercise of professional judgment in performing the audit and in preparing related reports, and the existence of quality controls and external peer reviews.

### 2-202 Competence (GAGAS 3.39)

The staff assigned to perform the audit should collectively possess adequate professional competence for the tasks required.

a. This standard requires that those assigned to the job collectively have the technical knowledge, skills, and experience necessary for the task at hand. Their qualifications should be commensurate with the scope and complexities of the assignments. 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.

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; to devise and apply effective audit procedures; to determine facts; to make reasonable judgments and decisions; and to prepare objective and effective reports.

c. The continuing education and training may include such topics as current developments in audit methods, accounting, assessment of internal controls, principles of management and supervision, financial management, statistical sampling, evaluation design, and data analysis. It may also include subjects related to the auditor's field of work, such as public administration, public policy and structure, industrial engineering, economics, social sciences, and information technology.

d. GAGAS 3.45 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 and internal specialists should ensure that such specialists are qualified in their area of specialization (see D-302c).

e. 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.

f. 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 skill and should assure maintenance of acceptable standards.

g. 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. Similarly, when performing financial audits, auditors should be knowledgeable in Generally Accepted Accounting Principles (GAAP), the AICPA’s Generally Accepted Auditing Standards (GAAS) for field work and reporting, and the related Statements on Auditing Standards (SAS). Again, they should also be competent in applying these standards and SASs to the task assigned.

## **2-203 Independence (GAGAS 3.03)**

In all matters relating to the audit work, the audit organization and the individual auditor, whether Government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence.

a. As an employee of DCAA, the contract auditor’s primary responsibility is to protect the interests of the Government. However, the auditor’s effectiveness depends on the ability to develop and evaluate facts and arrive at sound conclusions objectively (based on unbiased judgments) and independently (not subject to influence or control by others). The matter of independence and objectivity also requires that the auditor not identify so closely with contractor personnel that practices or decisions of the contractor go unexamined or are examined only cursorily.

b. Each auditor has an obligation to refrain from entering into any relationship (financial, social, or other) with contractors and their officers and employees, that would impair his or her objectivity or reflect discreditably on him/her or the DoD. It is essential that the auditor observe the prescribed Joint Ethics Regulations (DoD 5500.7-R) to ensure compliance with the ethical standards demanded of all public servants.

c. To comply with the standard, an auditor should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence and, thus, is not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work. In this connection, there are three general classes of impairments that the auditor should consider: personal, external, and organizational. If one or more of these impairments affect an auditor’s capability to perform the work and report impartially, that auditor should either decline to perform the work, or in those situations in which the Government auditor, because of a legislative requirement or for other reasons, cannot decline to perform the work, the impairment(s) should be reported in the scope section of the audit report. DCAA policy (see 2-S103.1b(5)) does not allow auditors with a personal or external impairment to work on any assignment affected by the impairment. Therefore, although GAGAS provides for a scope restriction, such restriction will not be used in DCAA reports.

### **2-203.1 Personal Impairments**

a. Personal impairments result from relationships and beliefs that might cause an auditor to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way. Auditors are responsible for notifying the appropriate officials within DCAA if they have any personal impairment to independence (see 2-S103.1). Examples of personal impairments of individual auditors include, but are not limited to, the following:

(1) immediate family or a close family member who is a director or officer of the audited entity, or as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit (immediate family member is a spouse, spouse equivalent, or dependent (whether or not related); a close family member is a parent, sibling, or nondependent child);

(2) financial interest that is direct, or is significant/material though indirect, in the audited entity or program;

(3) responsibility for managing an entity or for decision-making that could affect operations of the entity or program being audited, for example as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision-making, supervisory, or ongoing monitoring function for the entity, activity, or program under audit (The auditor's independence is impaired if the auditor performed nonaudit services for a contractor that affect information that is the subject of audit and management does not take responsibility for this information. The auditor needs to be free from this personal impairment for the period covered by the audit, and for the period in which the audit is being performed and reported.);

(4) concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records (specifically, when such services involved preparing source documents or originating data; posting transactions; authorizing, executing, or consummating transactions; maintaining an entity's bank account or having custody of the audited entity's funds; or exercising or having authority on behalf of the entity);

(5) preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit;

(6) biases, including those induced by political, ideological, or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of Government; and

(7) seeking employment with an audited organization during the conduct of the audit.

b. Audit organizations should include as part of their internal quality control system requirements to identify personal impairments and assure compliance with GAGAS independence requirements. At a minimum, audit organizations should:

- Establish policies and procedures that will enable the identification of personal impairments to independence, including whether performing nonaudit services affects the subject matter of audits and applying safeguards to appropriately reduce that risk.
- Communicate the audit organization's policies and procedures to all auditors in the organization and ensure understanding of requirements through training or other means, such as auditors periodically acknowledging their understanding.
- Establish internal policies and procedures to monitor compliance with the audit organization's policies and procedures.
- Establish a disciplinary mechanism to promote compliance with the audit organization's policies and procedures.
- Stress the importance of independence and the expectation that auditors will always act in the public's interest.

DCAA's current system to comply with these requirements is described in 2-S10.

c. GAGAS 3.05 states that when auditors use the work of a specialist, they should assess the specialist's ability to perform the work and report the results impartially. [Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists. This section does not apply to DCAA technical audit specialists.] If the specialist has an impairment to independence, the auditor should not use the work of that specialist. All Executive Branch Federal employees are required to follow the Office of Government Ethics Joint Ethics Regulations, which require employees to be impartial and free from conflicts of interest in the performance of their official duties. As a result, DCAA has determined that the ethics policies and procedures of the specialist' organizations provide reasonable assurance of the impartiality of specialists employed by other Executive Branch agencies, e.g., DCMA. Therefore, additional documentation are not required when using the work of those specialists. In obtaining representations from specialists employed by DCAA, follow the guidance in 2-S103.1.

d. When the audit organization identifies a personal impairment to independence, the impairment needs to be resolved in a timely manner. In situations where the personal

impairment is applicable only to an individual auditor on a particular assignment, the audit organization may be able to mitigate the personal impairment by requiring the auditor to eliminate the personal impairment. For example, the auditor could sell a financial interest that created the personal impairment, or the audit organization could remove that auditor from any work on that audit assignment. Auditors participating in the audit assignment, including those who perform reviews of a report, and all others within the audit organization, who can directly influence the outcome of the audit, need to be free from personal impairments. If the personal impairment cannot be mitigated, the audit organization should withdraw from the audit. In situations in which Government auditors cannot withdraw from the audit because of a legislative requirement or for other reasons, the impairment should be reported in the scope section of the audit (see 2-203c).

e. Nonaudit services. GAGAS Sections 3.10 through 3.18 contain guidance for audit organizations that provide nonaudit services. Audit organizations may perform nonaudit services that do not violate two overarching principles:

- They should not provide nonaudit services that involve performing management functions or making management decisions.
- They should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of audits.

Nonaudit services that do not violate the two overarching principles are divided into routine and non-routine nonaudit services.

(1) Routine nonaudit services. DCAA's nonaudit services consist primarily of providing routine advice and recommendations, which does not impair the auditor's independence. Auditors may participate on committees or task forces with the contractor and/or other Government agency personnel in a purely advisory capacity to provide advice on issues related to the knowledge and skills of the auditor without impairing their independence (see 1-800 and 15-305.1). However, auditors should not make management decisions or perform management functions. For example, auditors can provide routine advice to the audited entity and management to assist them in activities such as establishing internal controls or implementing audit recommendations, answering technical questions, and/or providing training. The decision to follow the auditor's advice remains with management of the audited entity. These types of interactions are normal between the auditor and the management of the audited entity, given the auditor's technical expertise and the knowledge the auditor gains of the audited entity's operations. An auditor may also provide tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies that may be used by management.

(2) Non-routine nonaudit services. Non-routine nonaudit services may impair independence as they require the auditor to go beyond providing routine advice (e.g., participating in IT system design and installation). Therefore, DCAA auditors generally should not perform non-routine nonaudit services. In rare instances where the FAO believes non-routine nonaudit services may be warranted, the matter should be elevated to Headquarters (PAS) through the region, prior to agreeing to provide such services.

## 2-203.2 External Impairments

a. External impairments to independence occur when an auditor is deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, external to the audit organization, such as from management and employees of the audited entity or outside organizations. In the DCAA environment, some of the external factors that can restrict the audit or infringe on the auditor's ability to form independent and objective opinions and conclusions include: procurement or contracting officers' interference in the scope and character of the audit that could modify audit results; denial of access to sources of information, such as books, records, and supporting documents or officials and employees of the contractor under audit; external interference in the assignment of personnel to the audit task; actions by contractors significantly influencing

the auditor's judgment regarding the content of the audit report; and unreasonable restrictions on the time allowed to competently complete the audit assignment.

b. An audit organization's internal quality control system for compliance with GAGAS independence requirements should include internal policies and procedures for reporting and resolving external impairments (see 2-S10).

### **2-203.3 Organizational Impairments**

Government audit organizations' capability to perform the work and report the results impartially can be affected by their place within Government and the structure of the Government entity to which the audit organization is assigned to audit. Government auditors can be presumed to be free from organizational impairments to independence when reporting externally to third parties if their audit organization is organizationally independent from the audited entity. To achieve maximum independence, auditors and their audit organizations not only should report to the highest echelon within their Governmental component, but should be organizationally independent. DoDD 5105.36 (see Supplement 1-1S1) established DCAA as an independent agency of DoD; accordingly, an environment exists where DCAA can function in an independent, objective manner in performing its contract audit services.

### **2-204 Professional Judgment (GAGAS 3.33)**

a. Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results. This standard requires auditors to exercise reasonable care and diligence, to observe the principles of serving the public interest, and to maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work. This standard also imposes a duty on each professional within an audit organization to observe GAGAS.

b. 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.

c. Every auditor assumes the duty to exercise such skill as he or she possesses, with reasonable care and diligence. 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. However, because no auditor can guarantee that the audit will be performed without fault or error, exercise of professional judgment guarantees good faith and integrity, not infallibility.

d. 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 supervisory auditor and FAO manager, who are expected both 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.

e. Professional judgment requires the auditor to exercise professional skepticism. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses his or her knowledge, skill, and ability to diligently perform the gathering and objective evaluation of evidence.

f. Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process.

g. The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.

h. The exercise of professional judgment provides reasonable assurance that the contractor's representations are free of material misstatement, or significant inaccuracies in data will likely be detected if they exist. 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. The audit objective is to obtain sufficient competent evidential material to provide a reasonable basis for forming an opinion. Audit evidence which is obtained by selective testing of the data being audited involves judgment both regarding the areas to be tested and the nature, timing, and extent of the tests to be performed.

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.

j. Because of the characteristics of fraud, particularly those involving concealment and falsified documentation, a properly planned and performed audit may not detect a material misstatement, especially when documentary evidence has been falsified or when an intentional misstatement has been concealed through collusion of knowledgeable parties.

## **2-205 Quality Control and Assurance (GAGAS 3.49)**

Each audit organization performing audits in accordance with these standards should have an appropriate internal quality control system in place and undergo an external quality review.

a. A strong, well-documented internal quality control system has been in place within DCAA since its inception.

(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 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 President's Council on Integrity & Efficiency (PCIE) External Quality Control Review Guide.

b. Audit organizations performing audits in accordance with GAGAS should have an external peer review at least once every three years by reviewers independent of the organization being reviewed. The external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with

applicable professional standards. For DCAA, this function is performed primarily by the DoDIG. Audit organizations should take remedial, corrective actions as needed based on the results of a peer review.

**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 shall perform an engagement only if he or she has 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) Objective – 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) Measurable – Criteria should permit reasonable, consistent measurements. That is, measurable criteria provide results that would be substantially duplicated by different people using the same measurement methods.

(3) Complete – Criteria should be sufficiently complete so that relevant factors that would alter a conclusion about subject matter are not omitted. The completeness of the criteria affects both the relevance and the reliability of the subject matter presented.

(4) Relevant – To be relevant the criteria must be fundamentally related 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 Government Auditing Standards (GAS) incorporate the AICPA fieldwork standards for attestation and financial statement audits (including applicable SASs and Attestation standards) and prescribe additional standards. This section explains how the attestation fieldwork standards and the additional Government standards are integrated with contract audit field work guidance. The field work standards explained in this section are to be followed in performing attestation audits and financial statement audits.

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

The work is to be adequately planned and auditors should consider materiality, among other matters, in determining the nature, timing, and extent of auditing procedures, and in evaluating the results of those procedures.

a. This standard concerns the timeliness of audit procedures, and the orderliness of their application. It places upon the auditor the responsibility for scheduling in advance for an effective and timely audit. In addition, auditors should follow up on known significant findings and recommendations from previous audits that directly relate to the audit being performed.

b. Before beginning an audit assignment, it is essential to coordinate with contracting officials (the customer) to understand the purpose of the audit; contractual, regulatory, or other factors pertinent to the evaluation; and the type of report to be prepared upon completing the assignment. The initial planning phase includes an evaluation of pertinent files, such as the working papers of 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.

c. The auditor 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. 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.

d. The auditor should consider whether specialized IT related skills are needed to help determine the impact of IT on the overall audit. For example, the auditor needs to assess if special IT skills are needed to help understand the flow of transactions through the system, to help determine the nature of the accounting control activities, or to help design and perform the audit procedures necessary to evaluate the system. If specialized skills are needed, the auditor should seek the assistance of a professional possessing such skills, who may be within either DCAA or Government procurement organizations. If the use of such a professional is planned, the auditor should have sufficient IT related knowledge to:

- (1) communicate the objectives of the other professional's work,
- (2) evaluate whether the specified procedures will meet the auditor's objectives and
- (3) evaluate the results of the procedures applied as they relate to the nature, timing, and extent of other planned audit procedures.

The auditor's responsibilities with respect to using such a professional are equivalent to those for other assistants functioning as members of the audit team.

e. Before preparing audit programs, a risk assessment should be performed. A skillfully performed risk assessment should provide information about the size and scope of the contractor's activities and 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. Tests to determine the significance of such matters are to be performed in the detailed audit work and should be carefully set out in the audit program and the report. It should be emphasized, however, that the risk assessment discussed here is primarily a review of prior audit work (e.g., permanent files). At major contractors, the main source of internal control information is normally the applicable system audit which is summarized on the internal control audit planning summary (ICAPS) sheet in the permanent file (see 3-300 and 5-100). To the extent that this prior audit work does not provide the auditor with adequate planning information, the scope of the audit being planned may have to be expanded.

f. A written program should be prepared for each evaluation 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. 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, review, 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 Supervision (GAGAS 6.04a)**

Assistants are to be properly supervised. This standard places upon the auditor the responsibility for ensuring that subordinate staff members receive appropriate guidance.

a. When assistants are used, the amount of preparatory training and the direct on-the-job supervision required on a given assignment will vary according to the assistants' experience and competence. The auditor-in-charge is responsible for ensuring that assistants are appropriately instructed in the particular segments of work assigned and that their work is professionally competent. Responsibility cannot be severed from authority; the auditor-in-charge, as well as other supervisory auditors, must exercise due care in supervising assistants and in reviewing their work and judgment.

b. Supervisory review should be directed to both the substance and the method of auditing. The review should ensure that:

- (1) the auditor conforms 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,
- (4) the working papers provide adequate evidence to prepare a meaningful report, and
- (5) the auditor will accomplish the audit objectives. Documentation of supervisory reviews should be prepared and retained.

c. Supervision of individual audit assignments applies before, during, and after completion of the field work. Oral and written instructions, preparation or approval of detailed audit programs, on-site guidance, and review of working papers and report drafts are all 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. It should not be inordinately reduced because of problems presented by the geographic location of the audit site. 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 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 team leader is primarily responsible for preparing and executing the audit program and for drafting the audit report. The designation of team leader is made separately for each assignment; the team leader on one assignment may next act in an assisting capacity in another, more complex assignment. Thus, the 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. In addition to his or her participation, the team leader may 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 mainly 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 team leader understands clearly the purpose and scope of the audit, the time limitations, 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 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 steps tailored specifically for the assignment, and with a time budget in corresponding detail (3-103). 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 field work. 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, although this should preferably have been 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, frequently enough to:

- (1) give timely technical guidance on audit or accounting problems,
- (2) coordinate on any major changes the team leader proposes to make to the audit program or time budget, and
- (3) maintain familiarity with the status of the audit. These supervisory activities can generally be conducted more effectively by visits than by telephone contact.

j. After the conclusion of an assignment, the supervisory auditor will review the working papers and the report draft for 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 may also find it necessary to 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 should participate in entrance, exit, and problem solving 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 monthly the status and progress of each team's performance with its supervisor.

n. The FAO manager should review all significant audit reports; other audit reports should be reviewed selectively. 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 should 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 redelegation of authority to sign audit reports and identifies those audit reports in 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's work shall include the examination or development of sufficient evidence to afford a reasonable basis for the auditor's conclusions and recommendations regarding cost representations, management decisions influencing costs, financial statements, or any other matters requiring the auditor's opinion (see 3-104.14).

### **2-303 Auditor Communication (GAGAS 6.06 – 6.09)**

Auditors should communicate information to the appropriate officials of the organization audited, and the individuals contracting for or requesting the audit services, regarding the nature, timing, and extent of planned testing and reporting; and the level of assurance.

a. Auditors should communicate the following information related to the conduct and reporting of the audit to the individuals who requested the audit (for DCAA, this is normally the contracting officer):

- The auditor's responsibilities, including their responsibilities for testing and reporting on internal controls and compliance with laws and regulations.
- The nature of any additional testing of internal controls and compliance required by laws and regulations.
- Any potential restriction of the auditor's report to reduce the risk that the needs or expectations of the parties involved may be misinterpreted.
- If an audit is terminated before it is completed, auditors should write a memorandum for the record that summarizes the results of the work and explains why the audit was terminated.
  - b. Auditors should also communicate the above information to a representative of the organization audited (audit liaison, corporate controller, chief financial officer, etc.). DCAA typically does not communicate with the audit committee.

### **2-304 Audit Follow-up (GAGAS 6.10 – 6.12)**

Auditors should consider the results of previous audits and attestations and follow-up on known significant findings and recommendations that directly relate to the objectives of the audit being undertaken.

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 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 6.15 – 6.20)**

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 compliance with laws and regulations applicable to the costing and pricing of Government contracts. In planning review-level or agreed-upon procedure level audits, GAGAS requires auditors to be alert to situations or transactions that could be indicative of fraud, illegal acts, or violations of provisions of contracts. If indications of fraud, illegal acts, or violations of provisions of contracts exist, auditors should apply specific procedures directed to ascertain whether fraud, abuse or violations of provisions of contracts has occurred.

When contracts are subject to specific Federal laws and regulations where violation may entail contractual penalties, contracts are required to describe the general provisions of the law and the penalty or penalties for violation. Examples of these Federal laws and regulations include the Truth in Negotiations Act, the Cost Accounting Standards, the Service Contract Act of 1965, the Davis-Bacon Act of 1931, and the Walsh-Healy Public Contracts Act of 1936.

a. To comply with this standard, the auditor is responsible for determining whether contractors have complied with contractual costing and pricing requirements. 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.

b. Reporting standards require a statement in the report regarding any significant instances of noncompliance disclosed by the examination and evaluation work. What is to be included in this statement requires judgment. The auditor cannot be expected to be completely knowledgeable about legal ramifications of all noncompliance issues, but

should seek assistance from DCAA and Government procurement legal counsel in instances when specific guidance is not available. Insignificant noncompliances need not be disclosed except where they could result in significant adjustments due to changed circumstances. When a noncompliance is reported, the auditor should place the findings in proper perspective. The extent of instances of noncompliance should be related to the number of cases examined to provide the reader with a basis for judging the prevalence of noncompliance.

c. In determining the nature, timing, and extent of the audit steps and procedures to test for compliance, the auditor should assess 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. At major contractor locations, this assessment of control risk is normally maintained in the Internal Control Audit Planning Summary sheet maintained in the permanent file.

d. 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.

e. In determining compliance with laws and regulations, the auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the results of contract audits. The auditor should also be aware of the possibility of illegal acts that could have an indirect and material effect on the results of contract audits.

### **2-306 Internal Control Structure (GAGAS 6.13 – 6.14)**

GAGAS requires the auditor to obtain a sufficient understanding of the internal controls 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)

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**

a. Auditors should perform procedures to obtain an understanding of the contractor's control environment, information and communication methods, risk assessment processes, monitoring processes, and relevant control activities. At major contractors, the evaluation to gain this understanding is normally performed and documented in separate audits of the contractor's systems, and summarized on the ICAPS forms (see 3-300 and 5-100).

b. The auditor's assessment of inherent risk and materiality for various cost accounts and classes of transactions is based on the auditor's understanding the control environment and the accounting systems. These judgments help the auditor decide if the effort to assess control risk below maximum is warranted by reduced substantive testing. This information should be documented on the ICAPS.

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

a. Control risk is the likelihood that a material misstatement will get through the internal control structure and into the financial statements and cost representations. Assess this risk by 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 to form an opinion. Substantive tests cover two general classes of auditing procedures to obtain evidential matter:

- (1) detailed tests of transactions and balances, and
- (2) analytical review procedures applied to financial information.

b. GAGAS does not require the auditor to assess control risk below maximum. The auditor may choose not to rely on the internal control structure 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. In these

circumstances, more evidence is needed from substantive tests to form an opinion. However, at major and larger nonmajor contractors with clearly defined internal control structures, the testing needed to assess control risk below maximum is more likely to reduce the need for substantive testing.

c. Use the understanding of the internal control structure and the assessed level of control risk to design substantive tests for auditing the contractor's cost estimates or representations. When the internal control structure is strong, the auditor should rely on it and, therefore, reduce the amount of substantive testing in a particular audit area. For example, as the risk decreases, the nature and/or timing of substantive tests may be changed, or the extent of testing may be reduced. In these circumstances, identify in the working papers the controls being relied upon, perform tests of the controls to evaluate their effectiveness, and document these tests and the conclusions reached (see 3-300, 5-108 and 5-109).

### **2-307 Working Papers (GAGAS 6.22)**

The AICPA and Government Auditing Standards (GAS) require auditors to prepare and retain audit documentation (working papers). The form and content of the documentation should be designed to meet the circumstances of the particular audit.

a. Working papers should contain sufficient information to enable an experienced auditor, who has had no previous connection with the audit, to ascertain from the working papers the evidence that supports the auditors' significant judgments and conclusions. Working papers that support significant findings, conclusions, and recommendations should be complete before auditors issue their report. This includes the documentation of the final supervisory auditor review and approval and any supervisory auditor-directed supplemental work impacting the conclusions and judgments. However, 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 significant conclusions and judgments). 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 should the auditor issue an audit report when incomplete elements of the working papers are significant to the audit conclusions. Significant revisions to the audit working papers after the audit report is issued are allowed only under specific circumstances and conditions described in 4-409.

b. Audit documentation performed under GAGAS should contain the following additional working paper documentation requirements not explicitly addressed in the AICPA Standards:

- The objectives, scope and methodology, including any sampling and other selection criteria used.
- Documentation of the work performed to support significant judgments and conclusions, including descriptions (identification) of transactions and records examined that would enable an experienced auditor to examine the same transactions and records.
- Evidence of supervisory reviews of the work performed.
- The auditor's consideration when evidential matter obtained is highly dependent on computerized information systems and the auditor is not relying on the internal controls over those computer systems that produced the information.

- The auditor's determination that certain additional GAGAS do not apply or that an applicable standard was not followed, the reasons, and the known effect that not following the applicable standard had, or could have, on the audit.
  - c. Additional guidance concerning the sufficiency of audit evidence and working papers is presented in 3-104.14 and 4-400.

**2-308 Developing Elements of Findings (GAGAS 6.21)**

Audit findings should contain the elements of criteria, condition, effect, and cause when problems are identified. The elements needed for a finding depend entirely on the objectives of the audit. When problems are identified, to the extent possible, auditors should plan audit procedures to develop the elements of a finding to facilitate developing the auditors' report.

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

### 2-401 Introduction

The Generally Accepted Government Auditing Standards (GAGAS) incorporate the AICPA reporting standards for attestation and financial statement audits (including applicable SASs and Attestation standards) and prescribe additional standards. This section identifies the additional Government reporting standards and explains how they are integrated with contract audit reporting guidance.

### 2-402 Reporting Compliance with Generally Accepted Government Auditing Standards (GAGAS 6.29)

- a. Audit reports should state that the audit was made in accordance with GAGAS.
- b. This statement refers to all the applicable standards that the auditor should have followed during the audit. The determination of applicable standards is a matter of professional judgment.

### 2-403 Reporting on Compliance with Laws and Regulations, Deficiencies in Internal Controls, Fraud, Illegal Acts, Violations of Provisions of Contracts (GAGAS 5.08 and 6.32)

- a. Audit reports should either:
    - (1) describe the scope of the auditor's testing of compliance with laws and regulations and internal control over financial reporting and present the results of those tests or provide an opinion; 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 instances of fraud and illegal acts unless clearly inconsequential, and violations of provisions of contracts that are material, other material noncompliances, and reportable conditions in internal control applicable to:
- the subject matter, or assertion of the engagement, or
  - financial reporting.

When fraud or suspected irregularities are discovered, DCAA guidance is for the auditor to prepare a Form 2000 (see 4-700) instead of including the issue in the audit report.

- b. When auditors report separately on compliance and controls, audit reports 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 10-304.3c and 10-306).

- c. Auditors should report significant deficiencies in internal controls and noncompliances that are material to the subject matter or assertion on a "real time basis" (see 10-413).

- d. The audit follow-up field work standard requires auditors to report the status of uncorrected deficiencies from prior audits that affect the current audit (see 10-306b).

### 2-404 Privileged and Confidential Information (GAGAS 6.46)

If certain pertinent information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary.

### 2-405 Report Issuance and Distribution (GAGAS 6.49)

Audit reports are to be submitted by the audit organization to the appropriate officials of the organization audited and to the appropriate officials of the organizations requiring

or arranging for the audits, including external funding organizations, unless legal restrictions prevent it. DCAA normally submits the audit report to the contracting officer responsible for acting on the audit recommendations. 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.

**2-406 Reporting Views of Responsible Officials (GAGAS 6.41)**

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. However, instead of disclosing the issue in an audit report, DCAA guidance on suspected irregularities is to issue a Form 2000 and auditors should follow guidance in 4-700 regarding discussions with the contractor.

**2-407 Application of the Reporting Standards**

DCAA has developed reporting guidance (see Chapter 10) which complies with all aspects of the GAGAS. The AICPA standards and requirements for attestations, examinations of prospective financial statements, and agreed-upon procedures have been given due regard in developing the report guidelines where the audit objectives and circumstances are similar to those encountered by an independent public accountant.

## **2-500 Section 5 --- Field Work Standards for Operations Audits (Performance Audits)**

### **2-501 Introduction**

In the contract audit environment, performance audits are more commonly described as operations audits. The objectives of evaluating the economy and efficiency of performance and the attainment of desired results are similar, but the contract auditor emphasizes economy and efficiency, as these factors relate to the reasonableness of costs to be charged to Government contracts. GAGAS, Chapter 7, defines the field work standards associated with performance audits, which are only applicable to the operations audits that DCAA performs.

### **2-502 Planning (GAGAS 7.02)**

a. Work is to be adequately planned. This includes defining the audit objectives and planning how they can be attained while establishing a balance between audit scope, time frames, and staff-days to be spent to ensure optimum use of audit resources. Planning is a continuous process throughout the audit, therefore, auditors should consider the need to make adjustments to the audit objectives, scope, and methodology as work is being completed. The details of the plan for the audit should be included in the audit program.

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. Skill and knowledge of the personnel to staff the assignment must be taken into account, and requirements for the use of consultants, experts, and specialists should be assessed. The audit plan should assure contractor compliance with laws and regulations and provide for detection of potential abuse and illegal acts. Auditors should obtain an understanding of internal control as it relates to the specific objective and scope of the audit. Assessment of the effectiveness of the contractor's internal controls is as essential to the planning of operations audits as to the planning of financial audits.

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. General information concerning the planning and performance of the audit should be communicated to contractor management responsible for the process or program being audited.

### **2-503 Supervision (GAGAS 7.44)**

a. The staff is to be properly supervised. This standard places responsibility on the auditor and audit organization for seeing that staff who are involved in accomplishing the objectives of the audit receive proper guidance and supervision to ensure that the audit work is properly conducted, the audit objectives are accomplished, and staff are provided effective on-the-job training. External consultants and specialists also should be given appropriate guidance.

b. Supervisory reviews of audit work and the report should be timely. Supervisory reviews of the work conducted should be documented in the working papers.

**2-504 Legal and Regulatory Requirements, Fraud and Abuse (GAGAS 7.17)**

a. This field work standard requires that when laws, regulations, and other compliance requirements are significant to audit objectives, auditors should design the audit to provide reasonable assurance about detecting violations that could have a significant effect on the audit results. Auditors should determine which laws, regulations and provisions of contracts are significant to the audit objectives and assess the risk that violations could occur. The risk assessment should be documented.

b. GAGAS does not set precise standards for determining whether laws and regulations are significant to the audit objective. Operation audits performed by DCAA are subject to many laws and regulations, and audit objectives vary widely. Therefore, auditors may find the following approach helpful in determining whether laws and regulations are significant to the audit objective.

- Reduce the audit objective to questions about specific aspects of the area being audited (that is, purpose and goals, internal control, efforts, program operations, outputs, and outcomes).
- Identify laws, regulations and contract provisions that could significantly affect the answers to the questions that relate to the audit objectives.
- Determine if violations of those laws, regulations or provision of contracts could significantly affect the auditors' answers to the questions that relate to the audit objective.

An example of laws and regulations that can be significant to the objective of an operations audit are those that could significantly affect the acquisition, protection, and use of the contractor's resources, and the quantity, quality, timeliness, and cost of the products and services it produces and delivers. However, in a broader sense, a primary objective of virtually all DCAA audits is to ensure compliance with FAR cost principles.

c. Auditors should be alert to situations or transactions that could be indicative of illegal acts or abuse. Auditors should design the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. When assessing compliance with laws and regulations, the auditor should:

(1) Assess, for each applicable compliance requirement, the risk that abuse and illegal acts could occur.

(2) Based on that assessment, design steps and procedures to provide reasonable assurance of detecting abuse or illegal acts.

d. When information comes to the auditor's attention (through audit procedures, "tips," or other means) indicating that abuse or illegal acts may have occurred, the auditor should consider the potential impact of these acts on the audit results. If these acts could significantly affect the audit results, the auditor should extend the audit steps and procedures, as necessary, to determine whether the acts occurred; and, if so, to determine the extent to which these acts significantly affect the audit results.

**2-505 Considering Internal Controls (GAGAS 7.11 - 7.16)**

a. Auditors should obtain an understanding of management controls that are relevant to the audit. When internal controls are significant to audit objectives, auditors should obtain sufficient evidence to support their judgments about those 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.

c. 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. A complete evaluation of internal controls as a specific requirement would often be prohibitive in terms of available resources. Therefore, the auditor should concentrate attention on those controls which are important to audit objectives.

d. 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.

### **2-506 Audit Evidence (GAGAS 7.48)**

a. Sufficient, competent, and relevant evidence is to be obtained to provide a reasonable basis for the auditors' findings and conclusions. Auditors should consider whether they have obtained the evidence necessary to achieve specific audit objectives. When internal control or compliance requirements are significant to the audit objectives, auditors should also collect and evaluate evidence relating to controls or compliance.

b. Audit evidence may include tapes, films, and discs. Evidence may be categorized as physical, documentary, testimonial, and analytical. The evidence should meet the basic tests of sufficiency, relevance, and competence. (Also see 3-104.14 on evidence.) The working papers should reflect the details of the evidence and disclose how it was obtained.

### **2-507 Working Papers (GAGAS 7.66 - 7.71)**

a. Auditors should prepare and maintain audit documentation. Working papers related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor, who has had no previous connection with the audit, to ascertain from the working papers the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

b. Working papers serve to:

- (1) provide the principle support for the auditors' report,
- (2) aid auditors in conducting and supervising the audit, and
- (3) allow for the review of audit quality.

Audit documentation should be appropriately detailed to provide a clear understanding of its purpose and source and the conclusions the auditors reached, and it should be appropriately organized to provide a clear link to the findings, conclusions, and recommendations contained in the audit report.

c. Working papers for operations audits should contain the following audit documentation not explicitly addressed elsewhere in GAGAS:

(1) the objectives, scope, and methodology of the audit, including sampling and other selection criteria used;

(2) the auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reason, and the known effect that not following the applicable standard had, or could have had, on the audit;

(3) the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined; and

(4) evidence of supervisory reviews, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report.

**2-600 Section 6 --- Reporting Standards for Operations Audits (Performance Audits)****2-601 Introduction**

The reporting standards explained in this section apply only to DCAA operations audits.

**2-602 Government Reporting Standards for Performance Audits (GAGAS Chapter 8)**

a. Form: Auditors should prepare audit reports communicating the results of each audit. The form of the audit report should be appropriate for its intended use but should be written or in some other retrievable form. If an audit is terminated before it is completed, but the auditors do not issue an audit report, auditors should communicate the reason for terminating it to contractor management, the requestor, and other appropriate officials, preferably in writing.

b. Report Contents: The audit report should include the objectives, scope, and methodology; the audit results, including findings, conclusions, and recommendations as appropriate; a reference to compliance with GAGAS; the views of responsible officials; and, if applicable, the nature of any privileged and confidential information omitted.

(1) Objectives, Scope, and Methodology: The auditor should report the audit objectives and a description of the audit scope and methodology.

(2) Audit Findings: Auditors should report significant audit findings. Findings should be supported by providing credible evidence that relates to the audit objective. The findings should be presented in a manner to promote adequate understanding of matters reported, and to provide convincing but fair presentations in proper perspective.

(3) Audit Conclusions: Conclusions are logical inferences about the audit based on the auditors' findings and should represent more than just a summary of the findings. Conclusions should be clearly stated, not implied.

(4) Recommendations: Auditors should report recommendations for actions to correct problem areas and to improve operations.

(5) Statement Regarding Generally Accepted Government Auditing Standards (GAGAS): Auditors should report that the audit was made in accordance with GAGAS.

(6) Fraud, Illegal Acts, Violations of Provisions of Contracts, and Abuse: The audit report should include relevant information when auditors conclude, based on evidence obtained, that fraud, illegal acts, significant violations of provisions of contracts, or significant abuse either has occurred or is likely to have occurred. When auditors detect violations of provisions of contracts or abuse that is 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 fraud, 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. In some circumstances, auditors should report illegal acts directly to parties external to the audited entity (see 4-700).

(7) Internal Controls: Auditors should report the scope of their work on internal controls and any significant weaknesses found during the audit. When auditors detect deficiencies in internal control that are not significant, they should communicate those deficiencies in a separate letter to appropriate officials of the audited entity (or in a separate appendix of the audit report) 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.

(8) Views of Responsible Officials: Auditors should report the views of responsible officials of the audited program concerning auditors' findings, conclusions, and recommendations, as well as corrections planned.

(9) Privileged and Confidential Information: If certain information is prohibited from general disclosure, auditors should report the nature of the information omitted and the requirement that makes the omission necessary.

c. Report Quality Elements: The report should be timely, complete, accurate, objective, convincing, and as clear and concise as the subject permits. The report should include only information, findings, and conclusions that are supported by sufficient, competent, and relevant evidence in the audit documentation. If data are significant to the audit findings and conclusions, but are not audited, the auditors should clearly indicate in their report the data's limitations and not make unwarranted conclusions or recommendations based on those data. The report should recognize positive management accomplishments, if applicable to the audit objective. Such information allows for a fairer presentation of the situation by providing appropriate balance to the report. In addition, inclusion of such accomplishments may be applicable elsewhere.

d. Report Issuance and Distribution: Auditors should submit audit reports to the appropriate officials of the organization audited, and to the appropriate officials of the organization requiring or arranging for the audits, including external funding organizations, unless legal restrictions prevent it. DCAA normally submits the audit report to the contracting officer responsible for acting on the audit recommendations. 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. Chapter 10 and 4-300 specify disclosure restrictions applicable to contract audits performed by DCAA.

e. Section 10-400 provides reporting guidance for DCAA performance (i.e., operations) audits that fully complies with these reporting standards.

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

### 2-S101 INTRODUCTION

DCAA's quality program is based on the precepts of Total Quality Management (TQM). DCAA's quality control program is an important subset of the Agency's overall quality program. TQM emphasizes "prevention" as a means for reducing errors and rework. However, 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 its 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 the necessary accounting and financial advisory services for the DoD, and other agencies, as appropriate. In accomplishing this mission, the Director of DCAA has fully committed the Agency staff to attain the highest level of integrity, competence, and customer satisfaction. This is best explained through our vision statement set forth as the Agency's Commitment to Excellence, which says:

"In support of the National Interest, we are dedicated to providing timely and responsive audits, reports, and financial advisory services to the Department of Defense contracting officers and other customers.

Our aim is to be THE audit organization with the foremost reputation for competence, integrity, and customer satisfaction by:

- Creating an environment of teamwork, open communication, trust, and mutual respect, and
- Developing highly qualified employees dedicated to the concept of continuous improvement."

Good working relationships and open communications with customers will minimize potential conflicts between the customer's 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, three 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) serves as the Agency focal point for the TQM program.

(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), Special Projects (PSP), and Quality Assurance (PQA).

(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.

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, a Special Assistant to the Regional Director (RQ), and a Regional Quality Assurance (RQA) Chief.

(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, a Special Assistant to the Field Detachment Director, and a Quality Assurance (QA) Chief.

(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 or 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. Among these responsibilities are:

- coordinating with customers,
- establishing and monitoring realistic team audit plans,
- establishing and monitoring team goals,
- scheduling and assigning team workload,
- using the zero-based budgeting technique on audit assignments,
- performing peer reviews, and
- identifying potential audit process improvements.

e. Quality Assurance (QA)

DCAA's Quality Assurance (QA) organization is responsible for the management and execution of the quality assurance program. The QA organization is comprised of a Headquarters division (PQA) and six Regional/Field Detachment divisions (RQA/FDQA). The Headquarters QA division routinely teams with the regional and Field Detachment divisions to plan and execute the Agency's quality assurance program. The QA team performs:

- formal internal QA reviews based on guidelines adapted from those established by the President's Council on Integrity and Efficiency (PCIE) and
- QA-related review projects on both an Agency-wide and regional basis.

The PCIE guidelines are used by various IG organizations when conducting their external peer group reviews required by the Government Auditing Standards. In performing both the PCIE-based internal reviews and QA projects, the QA team assesses compliance with applicable auditing standards and audit policy and procedures, assesses the need for new or enhanced audit policy guidance, and identifies best practices for Agency-wide use.

### 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, Integrity, and Objectivity**

#### **a. Objective.**

To provide reasonable assurance that all DCAA employees:

- maintain the level of independence required by the Agency's standards of conduct and by the generally accepted government auditing standard on independence;
- perform their professional responsibilities with integrity; and
- maintain objectivity in performing their professional responsibilities.

#### **b. Policies and Procedures.**

(1) General Requirements. DCAA employees at all organizational levels must adhere to the requirements on independence as stated in the GAGAS independence standard, DCAA Instructions, Contract Audit Manual (CAM), and Personnel Management Manual (PMM). Guidance on the GAGAS independence standard is incorporated in 2-203, which prescribes the DCAA auditor's responsibilities for independence when performing contract audits.

(2) Organizational Placement. DCAA has been organizationally positioned within DoD to ensure independence from the various DoD departments and agencies involved in the acquisition process. This provides the independent environment necessary for DCAA to accomplish its contract audit mission. Refer to the preceding section on Organization and 1-1S1 for further details.

(3) Audit Impairments. Occasionally, factors external to DCAA may restrict the audit or interfere with the auditor's ability to form independent and objective opinions and conclusions. When a limitation is identified, every effort should be made to remove the limitation or, failing that, report the limitation. DCAA expects each auditor to exercise prudent judgment in establishing audit scope, auditing procedures, and appropriate reporting of results.

(4) Personal Impairments. DCAA employees must maintain a high level of moral character and observe a high standard of ethical and professional conduct. Consistent with this responsibility, employees are required to refrain from any private business or professional activity which conflicts, or gives the appearance of conflicting, with official duties.

(5) Policies and Procedures. The following procedures must be followed to identify personal and external impairments and assure compliance with GAGAS independence requirements (see 2-203).

- Mandatory annual training sessions will be conducted to ensure understanding of the GAGAS auditor independence requirements.
- Upon completion of the annual independence training, all DCAA auditors will complete a Statement on Independence form (see Figure 2-S10-1) to document compliance with this GAGAS standard. This form is also to be completed by newly hired auditors prior to beginning any audit work. Individuals who are either not able to sign this statement or experience a situation after signing where they believe their independence and/or objectivity is or may be impaired should notify, in writing, the official who reviews their Statement on Independence form of their situation. Supervisors/FAO managers should coordinate with regional offices to eliminate any personal impairments of independence and/or resolve any outstanding concerns relating to independence. The supervisor/FAO manager's resolution of any impairment should be documented. If not resolved at the regional level, regions should elevate the independence issue to DCAA Headquarters, Policy and Plans, Attn: PAS.
- GAGAS also requires all auditors to 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." Supervisors/FAO managers shall contact the Designated Agency Ethics Official or Alternative Designated Agency Official at DCAA's General Counsel (DL) if they have questions concerning these standards of conduct. The Ethics Official will work with the supervisor/FAO manager to address the Government ethics questions. When a question also relates to an independence issue, the manager must separately resolve the independence issue by using the guidelines and procedures contained in this section. PAS will coordinate with the Ethics Official when both the Joint Ethics Regulations and the GAGAS standards provide guidance on the independence or ethics issue under concern.
- Each auditor is responsible for notifying his or her supervisor of any actual or potential personal and/or external impairment in writing. No auditor with a personal impairment will be permitted to work on any assignment that is affected by the impairment. Employees may be reassigned or rotated without change in grade to assure audit independence, integrity, and objectivity.
- Deviations from the above policies and procedures are subject to appropriate disciplinary action in accordance with the DCAA Personnel Management Manual, Chapter 50.

## 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, competent 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 Auditing Standards Division (PAS) 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

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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.



**Figure 2-S10-1  
Defense Contract Audit Agency  
Statement on Independence**

Background: Generally Accepted Government Auditing Standards (GAGAS), address Auditor Independence. Section 3.03 of GAGAS states that in all matters relating to the audit work, the audit organization and the individual auditor, whether Government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence. Personal Impairments are defined in Sections 3.07 through 3.18, and external impairments are defined in Sections 3.19 through 3.20. These requirements are discussed in detail in CAM 2-203 and 2-S10.

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Instructions: This form, which documents compliance with this GAGAS standard, is to be completed annually by all DCAA auditors and other Agency specialists providing audit support. This form is also to be completed by newly hired auditors prior to beginning any audit work. Individuals who are either not able to sign this statement or experience a situation after signing where they believe their independence and/or objectivity is or may be impaired should notify, in writing, their immediate supervisor of the situation. DCAA's Ethics Officer is also available for consultation.

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Statement: I have read and understand DCAA guidance in CAM 2-203 and 2-S10 (2-S103.1 Independence, Integrity and Objectivity), which provide coverage of GAGAS Sections 3.07 through 3.18, Personal Impairments, and Sections 3.19 through 3.20, External Impairments. I have also read and understand the guidance in CAM 1-800 Section 8 --- Auditor Participation on Contractor and Government Process Action Teams (PATs); Integrated Product Teams (IPTs); Management Councils; and Related Streamlined Acquisition Initiatives.

I state that I have neither personal nor external impairments that will keep me from objectively planning and conducting my assignment(s) and reaching independent conclusions based on the evidence. I will reevaluate my independence whenever my assignment is changed and whenever my circumstances change. If changes affecting either my independence or my objectivity occur subsequent to the completion of this form, I will promptly notify my immediate supervisor in writing of the situation.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Supervisor's Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Printed Name: \_\_\_\_\_