



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAS 730.3.B.2.4

February 18, 2010
10-PAS-005(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Guidance on Performing Internal Control Follow-Up Audits and Limited Scope Audits

This guidance supplements the guidance in MRD 09-PAS-020(NR), dated October 9, 2009, on performing internal control audits, specifically regarding follow-up audits, and MRD 08-PAS-041(R), dated December 19, 2008, on limited scope audit reports on internal controls.

Internal Control Follow-Up Audits

In MRD 09-PAS-020(NR), we informed you that we are performing a comprehensive reassessment of the process for evaluating and reporting on contractor internal controls and that in the meantime, based on audit priorities and available staffing, FY 2010 effort related to internal control audits is limited. However, FAOs should perform follow-up audits to verify the contractor's correction of previously-reported internal control deficiencies. FAOs should initiate such audits when the FAO is notified by the contractor (either directly or through the ACO) that it has implemented the appropriate corrective actions and sufficient transactions are available to adequately test the effectiveness of the corrective actions. The testing should include transactions over several cycles to ensure that the contractor has corrected the significant deficiencies/material weaknesses and that the corrected controls are implemented and operating effectively.

The scope of the follow-up audit will be limited to determining if the contractor corrected the previously-reported deficiencies. Therefore, the audit report should clearly state what was examined (in the subject and scope sections) and not provide an opinion on the adequacy of the contractor's system (either adequate or inadequate). Instead, the report should opine on whether the deficiencies have been corrected. If the contractor has not corrected all of the previously-reported deficiencies, the report should state that the examination noted significant deficiencies that are considered to be material weaknesses and provide details in the Statement of Conditions and Recommendations section of the report. The report should also recommend that the contracting officer pursue or continue the suspension of the percentage of progress payments or reimbursement of costs and, if applicable, disapprove the affected portions of the system. The enclosed audit report shell provides the appropriate follow-up audit report language to be used in the circumstances covered by this guidance and is available in APPS under Other Audit Guidance and on the DCAA Intranet.

MRD 09-PAS-021(R), dated October 22, 2009, states that when the prior opinion on the adequacy of the system is not current, it should be excluded from the applicable paragraphs in the Contractor Organization and Systems section and Scope of Audit section in related audit reports (e.g.,

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forward pricing audits). Instead, those paragraphs should indicate that a current audit of the system has not been performed. If the follow-up audit determines that the deficiencies have been corrected, the prior opinion on the system will no longer be current. However, in such cases, the applicable paragraphs in the Contractor Organization and Systems section and Scope of Audit section in related audit reports should discuss both the prior audit report opinion (e.g., the FAO previously reported that the system was inadequate due to significant deficiencies/material weaknesses) and the results of the follow-up audit (e.g., the FAO examined the contractor's corrective actions and determined that the previously-reported deficiencies have been corrected) and provide the relevant details, e.g., report numbers and dates. On the other hand, if the follow-up audit determines that the deficiencies have not been corrected, the applicable paragraphs in the Contractor Organization and Systems section and Scope of Audit section in related audit reports should continue to indicate that the system is inadequate and discuss the results of the follow-up audit. As discussed above, additional guidance will be issued once our assessment of the process for evaluating and reporting on contractor business systems and related internal controls is completed.

Limited Scope Audit Reports

MRD 08-PAS-041(R) provides guidance on issuing limited scope audit reports on internal control deficiencies identified in other than internal control audits. As we are reassessing our approach for performing and reporting on contractor internal controls, FAOs should also consider reporting internal control deficiencies in a limited scope audit report to report deficiencies identified in any in-process internal control audits. This will ensure that the contracting officer is promptly informed of identified significant deficiencies/material weaknesses so that appropriate action can be taken to ensure that the contractor corrects the deficiencies.

As discussed in the MRD 08-PAS-041(R), auditors must ensure that the audit package supporting the limited scope audit report stands on its own and documents sufficient work as a basis for the audit opinion and to demonstrate compliance with GAGAS (e.g., adequate planning and supervision, sufficient and current evidence).

FAO personnel should direct questions to their regional offices, and regional personnel should direct any questions to Auditing Standards Division, at (703) 767-3274 or e-mail: DCAA-PAS@dcaa.mil.

/s/
Kenneth J. Saccoccia
Assistant Director
Policy and Plans

Enclosure: a/s

DISTRIBUTION: C

Version No. 1.0	Follow-up Audit Report	December 2009
Reviewer's Approval and Date:		

DEFENSE CONTRACT AUDIT AGENCY



AUDIT REPORT NO. [Office Organizational Code]–[Year (4 digit)][Team Code][Five-Digit Activity Code][Last 3 digits of Assignment Number]



[date]

PREPARED FOR: [ACO, PCO, or Other]
 [Customer Name 1st Line]
 [Customer Name 2nd Line]
 [Customer Name 3rd Line]
 ATTN: [Attention To]
 [Customer Address 1st Line]
 [Customer Address 2nd Line]
 [City of Customer], [State of Customer] [Zip Code of Customer]
 [Country of Customer]

PREPARED BY: DCAA [Office Name]
 [Office Address 1st Line]
 [Office Address 2nd Line]
 [City of Office], [State of Office] [Zip Code of Office]
 Telephone No. [Main Phone Number of Office]
 FAX No. [Fax Number of Office]
 E-mail Address [E-Mail of Office]

SUBJECT: [Follow- up Audit Report on Previously Reported Significant Deficiencies/Material Weaknesses identified in Audit Report Number [Insert Audit Report Number] dated [Insert date of report]]

REFERENCES: *If applicable, include appropriate references.
 Relevant Dates: (See Page 8)*

CONTRACTOR: [Contractor Name 1st Line]
 [Contractor Name 2nd Line]
 [Contractor Name 3rd Line]
 [Contractor Address 1st Line]
 [Contractor Address 2nd Line]

[City of Contractor], [State of Contractor] [Zip Code of Contractor]
[Country of Contractor]

REPORT RELEASE RESTRICTIONS: See Page 9

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SUBJECT OF AUDIT

We have examined [*Contractor Name*] (*Contractor Acronym*)’s corrective actions related to significant deficiencies/material weaknesses in [*Contractor Acronym*] [*identify the internal control system*] reported in Audit Report number [*Insert the audit report number*] dated [*insert the date of the report*]. The contractor is responsible for correcting the reported significant deficiencies/material weaknesses. Our responsibility is to express an opinion on (*Contractor Acronym*)’s corrective actions based on our examination.

EXECUTIVE SUMMARY

[If applicable (10-210.2), this section gives a brief overview of the audit findings. Refer to 10-406. Below is an example of how the section may read when the deficiencies have not been corrected.]

Our examination disclosed that [*Contractor Acronym*]’s has not effectively implemented actions to correct the significant deficiencies/material weaknesses in [*Contractor Acronym*] [*identify the internal control system*] reported in Audit Report number [*insert the audit report number*] dated [*insert date of report*]. As a result, we continue to recommend you pursue suspension of a percentage of progress payments or reimbursement of costs in accordance with DFARS 242.7502. [*Include the following in reports on estimating and purchasing systems.*] We also continue to recommend disapproval of affected portions of [*Contractor Acronym*]’s [*purchasing or estimating*] system.

SIGNIFICANT ISSUES

- [*insert summary of significant issues/deficiencies*]
- [*if applicable*] [*Contractor Acronym*] agrees and is taking aggressive action to correct these deficiencies.

SCOPE OF AUDIT

Except for the qualifications discussed below [*omit if the report is not rendering a qualified opinion and there is no “Qualifications” section within the “Scope” paragraph*], we conducted our examination in accordance with generally accepted government auditing standards, except DCAA does not currently have an external opinion on its quality control system as required by GAGAS 3.55. The most recent external quality control review opinion expired on August 26, 2009. A review of DCAA’s quality control system is currently being performed. Our examination included:

- identifying relevant system control objectives and control activities,

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- obtaining an understanding of all applicable components of internal control for the identified control objectives and activities, and
- examining, on a test basis, evidence supporting whether the contractor effectively implemented corrective actions to correct the previously reported significant deficiencies/material weaknesses.

We evaluated the [*Contractor Acronym*]'s corrective actions related to the previously reported significant deficiencies/material weaknesses in the [*identify the internal control system*] using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- [*if applicable*] Department of Defense FAR Supplement (DFARS), and
- Contract Terms.

We believe that our examination provides a reasonable basis for our opinion.

QUALIFICATIONS

[*Separately identify and describe any special circumstances or conditions adversely affecting the audit or its results.*]

[*Conclude the Scope of Audit section with the inherent limitations paragraph as follows:*]

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over the [*insert name of system*] to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

RESULTS OF AUDIT

In our opinion, [*Contractor Acronym*] [*has or has not*] effectively implemented corrective actions to correct the significant deficiencies/material weaknesses in the [*identify the internal control system*] reported in Audit Report number [*insert audit report number*] dated [*insert date of report*].

[*If the paragraph above states that the contractor has not corrected the previously reported significant deficiencies/material weaknesses, include the next two paragraphs:*]

Our examination noted certain significant deficiencies that are considered to be material weaknesses in the design or operation of the internal control structure. In our judgment, these deficiencies could adversely affect the organization's ability to initiate, authorize, record, process, and/or report costs [*use "estimates" instead of "costs" for reports on the estimating system or budget and planning system*] in a manner that is consistent with applicable

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Government contract laws and regulations. As a result, we continue to recommend that you pursue a suspension of a percentage of progress payments or reimbursement of costs in accordance with DFARS 242.7502. *[Include the following for reports on the estimating system or purchasing system.]* We also continue to recommend disapproval of *[identify the portions of the system affected by the deficiencies]* portion(s) of *[Contractor Acronym]*'s *[purchasing/estimating]* system. These conditions are detailed in the "Statement of Condition(s) and Recommendation(s)" on page *[xx]* and summarized below:

[Briefly summarize the conditions]

Based on the results of our audit of the contractor's corrective actions related to the previously reported significant deficiencies/material weaknesses in the *[identify the internal control system]* and our control risk assessments, we will perform increased substantive testing (i.e., analytical procedures and transactions tests) in the following areas:

[List the audit areas affected.]

We only examined *[Contractor Acronym]*'s corrective actions related to the significant deficiencies/material weaknesses in the *[identify the internal control system]* reported in Audit Report Number *[insert the audit report number]* dated *[insert date of report]*. Accordingly, we express no opinion on *[Contractor Acronym]*'s system of internal controls taken as a whole.

[Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate.]

We discussed the results of our examination with *[Name and Title of contractor representative]* in an exit conference held on *[Date]*. *[If there are system deficiencies, briefly summarize the contractor's reaction here or, if applicable, state that there was no response and why, e.g., the contractor representative reserved comment pending discussions with the cognizant Federal agency official.]* We provided a draft copy of the Statement of Condition(s) and Recommendation(s) to the contractor's representative at the exit conference. *[When the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Put any rebuttals in the "Auditor's Response" portion of the explanatory notes and include the following statement.]* The complete text of the contractor's response appears as Appendix *[x]*.

[Use the guidelines provided in 10-210.5e(2) to prepare any other additional remarks.]

STATEMENT OF CONDITION(S) AND RECOMMENDATION(S)

[The statements of condition(s) and recommendation(s) are an integral part of the results of audit and should follow the narrative described in the Results of Audit. Alternatively, they may be included in attached appendixes. The presentation should follow the six-element outline as noted below to present a logical statement of condition(s) and recommendation(s).]

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The two main subheadings should be “Condition” and “Recommendation.” Although the six elements of an audit finding should not be addressed under separate subheadings, they must be included as part of the statement of condition to present a logical, convincing case. Refer to 10-409.

(1) Condition – This attribute identifies the nature of the deficiency, finding, or unsatisfactory condition by disclosing how things are.

(2) Criterion – This attribute establishes the legitimacy of the finding disclosing how things should be.

(3) Cause – This attribute gets to the root of the problem by answering the question, “Why did it happen?”

(4) Fact – Examples should be included to demonstrate to the contracting officials and contractor that the reported conditions do exist.

(5) Effect – This attribute convinces the reader that the condition is significant by answering the question, “What happened or could happen as a result of this condition? What is the harm or potential harm to the Government?”

(6) Recommendation – This attribute suggests remedial action answering the question, “What must be done to eliminate the cause of the condition?” If the relationship between the cause and the condition is clear and logical, the recommended action(s) will most likely be feasible and appropriately directed.]

CONTRACTOR ORGANIZATION AND SYSTEMS

[This section should furnish pertinent information necessary for the reader to understand the area audited. This information should be classified under separate subheadings for the organization and individual system(s). Refer to 10-410 for additional information and examples.]

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DCAA PERSONNEL

	<u>Telephone No.</u>
Primary contact(s) regarding this audit: [Auditor's Name], Auditor [Supervisor's Name], Supervisory Auditor	 [Auditor's Phone Number] [Supervisor's Phone Number]
Other contact(s) regarding this audit report: [FAO Manager's Name], Branch Manager [FLA Name], Financial Liaison Advisor	 [FAO Manager's Phone Number] [Phone Number of FLA]
	<u>FAX No.</u>
[Office Name] [FLA Name], Financial Liaison Advisor	 [Fax Number of Office] [Fax Number of FLA]
	<u>E-mail Address</u>
[Office Name]	 [E-Mail of Office]

General information on audit matters is available at <http://www.dcaa.mil/>.

RELEVANT DATES

[Use this section in customer requested assignments. The section should include, at a minimum, the dates of ACO and PCO requests and the dates of any extensions (see 10-211 and Fig. 10-2-3).]

AUDIT REPORT AUTHORIZED BY:

[FAO Manager's Name]
Branch Manager
DCAA [Office Name]

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

[All recipients of the audit report will be identified in this section of the report. See 10-412 and 10-212 for additional information.]

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[Customer Prepared For Email Address]

[Customer Name 1st Line]
[Customer Name 2nd Line]
[Customer Name 3rd Line]
ATTN: [Attention To]
[Customer Address 1st Line]
[Customer Address 2nd Line]
[City of Customer], [State of Customer] [Zip Code of Customer] [Country of Customer]

[Contractor Name 1st Line] [Contractor Email Address]
[Contractor Name 2nd Line]
[Contractor Name 3rd Line]
[Contractor Address 1st Line]
[Contractor Address 2nd Line]
[City of Contractor], [State of Contractor] [Zip Code of Contractor] [Country of Contractor]
(Copy furnished thru CFAO)

[Buying Command line 1] [E-Mail of FLA]
[Buying Command line 2]
ATTN: [FLA Attention line]
[FLA Address 1st Line]
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[City of FLA], [State of FLA] [Zip Code of FLA] [Country of FLA] [Phone Number of FLA]
FLA]

RESTRICTIONS

1. Information contained in this audit report may be proprietary. It is not practical to identify during the conduct of the audit those elements of the data which are proprietary. Make proprietary determinations in the event of an external request for access. Consider the restrictions of 18 U.S.C. 1905 before releasing this information to the public.

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2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.
3. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

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APPENDIXES

[Use as appropriate. Refer to 10-213 and 10-409 for additional information.]