



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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IN REPLY REFER TO

PAS 730.3.B.2.4

October 16, 2012  
12-PAS-027(R)

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

SUBJECT: Audit Guidance on the Use of Activity Codes and Documentation for Nonaudit Services

### **SUMMARY**

The purpose of this memorandum is to provide guidance on the use of activity codes for the performance of nonaudit services and general documentation requirements for nonaudit services. Nonaudit services should be performed only under activity codes designated as a nonaudit service and should fit within the parameters described in the DMIS definition for the activity code used. FAOs should prepare and maintain documentation of nonaudit services performed that is sufficient to enable FAO audit staff and other experienced auditors (e.g., internal and external reviewers) not associated with the assignment to understand the nature and scope of the work performed.

This MRD supersedes MRD 12-PAS-004(R), Audit Alert on Coordination of Nonaudit Services with the Region and Headquarters, dated February 9, 2012.

### **BACKGROUND**

As part of its review of DCAA nonaudit services for compliance with the GAGAS independence requirements, the DoDIG found that DCAA policies and procedures did not clearly define all nonaudit services that its auditors can provide. The DoDIG recommended that DCAA revise DCAA Management Information System (DMIS) codes and their associated definitions to clearly identify the activities performed or services provided. In response to the IG recommendation, we performed an assessment of the DCAA activity codes to identify the appropriate type of activity for each code. As a result of the assessment, the Activity Code Matrix and Activity Code Definitions in the DMIS User Guide have been revised to identify the type of activity that can be performed under each code. Each activity code is designated as an examination, agreed upon-procedures, performance audit, nonaudit service or other/administrative.

### **GUIDANCE**

#### Activity Codes for Nonaudit Services

GAGAS defines nonaudit services as professional services other than audits or attestation engagements. Nonaudit services should be performed only under one of the activity codes

October 16, 2012

12-PAS-027(R)

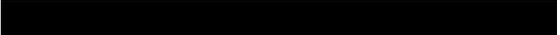
PAS 730.3.B.2.4

SUBJECT: Audit Guidance on the Use of Activity Codes and Documentation for Nonaudit Services

designated as such, and the services to be provided should fit within the parameters described in the DMIS definition for the particular activity code. Auditors should check the DMIS User Guide definitions when establishing an assignment to ensure that the proper activity code is used for the audit or service to be performed. The DMIS Activity Code Matrix and Definitions are available in the DMIS User Guide at the link below:



We have established a new activity code, 49800 Other Nonaudit Services, for nonaudit services that cannot be identified with any of the other nonaudit services activity codes. Effort under the 49800 activity code should be performed only after the FAO determines that providing the requested nonaudit service does not create a significant self-review threat (2011 GAGAS 3.14b) or management participation threat (2011 GAGAS 3.14f) to independence, either by itself or in aggregate with other nonaudit services, with respect to current or future audits. (The definitions of self-review threat and management participation threat are provided in the enclosed template.) The FAO should perform the assessment for independence threats using the GAGAS conceptual framework approach to independence and coordinate the assessment with the Regional Office and Headquarters PAS before accepting the engagement to perform the nonaudit service.

The GAGAS conceptual framework approach to independence and its application are discussed in the 2011 GAGAS 3.07 through 3.26 and illustrated in GAGAS Appendix II. (A link to the Government Auditing Standards (Yellow Book) is provided under the Reference Materials section of the DCAA Intranet Useful Audit Links webpage at: ) Policy has developed the enclosed template, Assessment of Threats to Independence – Other Nonaudit Services, to assist FAOs in applying the conceptual framework when considering the performance of a nonaudit service under activity code 49800. The assessment template also is available on the DCAA Intranet. FAOs do not need to perform this assessment for nonaudit services performed under other DMIS activity codes designated as nonaudit services. We are documenting the assessment for those nonaudit services at the Agency level.

DCAA will first start applying the 2011 GAGAS Revision to audits performed in Calendar Year (CY) 2013. However, since the underlying independence concepts and principles in the 2007 GAGAS are included in the 2011 GAGAS conceptual framework for independence, we believe that the conceptual framework is an appropriate tool for evaluating independence issues regardless of whether the 2007 GAGAS or the 2011 GAGAS apply. However, for any assessments performed during the remaining months of 2012, we also need to document consideration of the 2007 GAGAS requirements. Therefore, the template includes the applicable 2007 GAGAS references. The 2007 GAGAS does not preclude the use of a tool such as the conceptual framework and, as long as we also meet the 2007 GAGAS requirements, doing so does not represent early implementation of the 2011 GAGAS, which is not permitted. Headquarters PAS will assist FAOs with this through the required coordination process.

October 16, 2012

12-PAS-027(R)

PAS 730.3.B.2.4

SUBJECT: Audit Guidance on the Use of Activity Codes and Documentation for Nonaudit Services

Preparation and Filing of Documentation for Nonaudit Services

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

Documentation for work performed under activity codes designated as nonaudit services should be filed in Livelink under the appropriate 800 series file codes based on the descriptions and guidance in DCAAM 5015.1, Files Maintenance and Disposition Manual. Filing requirements for FLA services activities (30100, 30300, and 30550), activities related to investigative support, Form 2000 and Board of Contract Appeals cases (48600, 48610, and 49300), and the processing of public vouchers (41500) are currently under review. In the meantime, the applicable organizations should continue to follow their current filing practices for documentation related to activities performed under those codes until notified otherwise.

FAO personnel should direct questions regarding this memorandum 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](mailto:DCAA-PAS@dcaa.mil).

/Signed/  
John C. Shire  
Deputy Assistant Director  
Policy and Plans

Enclosure:  
Assessment of Threats to Independence –  
Other Nonaudit Services

DISTRIBUTION: E

## **Assessment of Threats to Independence - Other Nonaudit Services**

*This form should be used to assist the auditor in evaluating and documenting threats to independence and the application of safeguards using the GAGAS conceptual framework when considering performing a nonaudit service under activity code 49800 Other Nonaudit Services. For assignments to which the 2007 GAGAS apply (generally assessments performed in Calendar Year 2012), this conceptual framework assessment is a tool to assess whether a nonaudit service being considered for performance under activity code 49800 Other Nonaudit Services would violate either of the overarching independence principles (2007 GAGAS 3.22).*

***This assessment must be completed and coordinated with the Regional Office and Headquarters PAS before accepting the engagement to perform the nonaudit service. The approved form should be included with the documentation for the 49800 service.***

***Before completing this form auditors should consider the following:***

- *If the nonaudit service can be identified with the activities described in the DMIS User Guide for an activity code designated a nonaudit service other than 49800, the effort should be performed under that activity code and this assessment is not required. HQ has determined that those services do not impair independence when the activity performed is within the parameters described in the DMIS definition and in accordance with applicable guidance.*
- *Requestors' needs for DCAA services vary, depending on the specific circumstances. The auditor should ensure that they have a clear understanding of the requestor's needs and objectives (through discussions with the requestor). In some cases, it may be appropriate to perform the work as an audit rather than a nonaudit service.*
- *This form assumes that the nonaudit service is to be performed for a third party requestor (e.g., the contracting officer) and not the audited entity (the contractor). DCAA generally does not perform nonaudit services for the contractor. If there are circumstances that the FAO believes warrant the performance of a nonaudit service for the contractor, the FAO should coordinate with the Regional Office and Headquarters PAS before completing this assessment.*

**All references to GAGAS are to the 2011 GAGAS Revision unless otherwise noted.**

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### **PART I Defining the Nonaudit Services to be Performed**

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#### **1. What is the purpose/objective of the requested service?**

## Assessment of Threats to Independence - Other Nonaudit Services

**2. How is the requestor going to use this information?**

**3. Provide a detailed description of the nature and extent of the services to be provided, including, if applicable, the contractor financial periods covered by those services (generally, these would be the specific steps the auditor intends to perform).**

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### **PART II Consideration of Expressly Prohibited NAS**

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**4. The nonaudit services that are expressly prohibited by GAGAS are at GAGAS 3.36, 3.50, 3.53, 3.54, 3.56, 3.57, and 3.58. See 2007 GAGAS 3.29 for a similar list of nonaudit services that by their nature, “directly support the entity’s operations” and result in violation of one or both of the overarching principles. These activities or functions would impair auditor independence if performed for the audited entity or on behalf of the audited entity. DCAA generally does not perform nonaudit services for the audited entity (i.e., the contractor). Therefore, document below that the nonaudit service is to be performed for a third party requestor, not the contractor, and as a result, is not expressly prohibited by GAGAS.**

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### **PART III Application of Conceptual Framework - Evaluating Threats and Applying Safeguards**

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*The GAGAS conceptual framework approach to independence and its application are discussed in GAGAS 3.07 through 3.26 and illustrated in GAGAS Appendix II. Self-review and management participation threats are the threats generally considered inherent in the performance of nonaudit services. (These are also the threats that are inherent in the two overarching independence principles in 2007 GAGAS 3.22.) A threat would be considered significant if it would compromise the auditor’s professional judgment or create the appearance that the auditor’s professional judgment may be compromised (GAGAS 3.13).*

*Self-review threat is the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit (GAGAS 3.14b). (This is the threat that is inherent in the second overarching independence principles of the 2007 GAGAS - audit organizations must not audit their own work or provide*

## Assessment of Threats to Independence - Other Nonaudit Services

*nonaudit services in situations in which the nonaudit service is significant or material to the subject matter of the audit.)*

*Management participation threat is the threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing an audit (GAGAS 3.14f). (This is the threat that is inherent in the first overarching independence principles of the 2007 GAGAS - audit organizations must not provide nonaudit services that involve performing management functions or making management decisions.)*

**5. Document your assessment of whether performance of the nonaudit service would create a significant self-review threat in relation to the performance of current or future audits (GAGAS 3.14b and Appendix I A3.04) (including consideration of whether it would result in auditing our own work or providing nonaudit services that are significant or material to the subject matter of current or future audits (2007 GAGAS 3.22)) and the rationale for your conclusion. (Consider if there are any current or future audits for which the nonaudit service (1) could directly affect the contractor's assertion/the subject matter of the audit or (2) could otherwise result in the auditor not appropriately evaluating the results of judgments the auditor will make as part of this nonaudit service when forming a judgment significant to the current or future audit.)**

**6a. DCAA generally only performs nonaudit services that do not impair independence and do not require the application of safeguards. Therefore, if you identified a self-review threat that is considered significant, the nonaudit service should generally not be performed. However, if the FAO believes that the circumstances warrant the performance of this nonaudit service, explain the rationale below and document the safeguards that have been applied or can be applied. (Refer to GAGAS 3.16, 3.17 for examples of safeguards)**

**6b. Document your assessment of whether the application of safeguards eliminates or reduces the threat to an acceptable level and the rationale for that determination (e.g., how the application of the safeguards would reduce or eliminate the impact of the threat on the current or future audit to an acceptable level (GAGAS 3.16, 3.17 and 3.22)).**

**7. Document your assessment of whether performance of the nonaudit service would create a significant management participation threat in relation to the performance of current or future audits (GAGAS 3.14f and Appendix I A3.08), (including consideration of whether it would involve performing management functions or making management decisions (2007 GAGAS 3.22)) and the rationale for your conclusion. (DCAA generally does**

## Assessment of Threats to Independence - Other Nonaudit Services

*not perform nonaudit services for the audited entity, or on behalf of the audited entity. This significantly limits the risk of the auditor taking on the role of entity management, and therefore the risk of a management participation threat. In most cases, it should be sufficient to document that the nonaudit service is to be provided to a third party requestor, not the contractor, and does not involve taking on contractor management responsibilities or functions; therefore, there is no management participation threat. However, we cannot anticipate every service that the contracting officer may request. Therefore, in some cases, the auditor may need to consider whether the service to be provided could give the appearance that the auditor is taking on contractor management responsibilities.)*

**8a. As noted in 6a above, DCAA generally only performs nonaudit services that do not impair independence and do not require the application of safeguards. Therefore, if you identified a management participation threat that is considered significant, the nonaudit service should generally not be performed. However, if the FAO believes that the circumstances warrant the performance of this nonaudit service, explain the rationale below and document the safeguards that have been applied or can be applied. (Refer to GAGAS 3.16, 3.17 for examples of safeguards)**

**8b. Document your assessment of whether the application of safeguards eliminates or reduces the threat to an acceptable level and the rationale for that determination (e.g., how the application of the safeguards would reduce or eliminate the impact of the threat on the current or future audit to an acceptable level (GAGAS 3.16, 3.17 and 3.22))**

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## PART IV Consideration of Statutory or Regulatory Requirements

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*To be completed if it has been determined that the service is expressly prohibited by GAGAS or would create threats that cannot be eliminated or reduced to an acceptable level by application of safeguards.*

**9. If performing the nonaudit service would impair independence with respect to a required audit, document whether there are statutory or regulatory requirements to perform the nonaudit service, including, if applicable, a brief description of the statutory or regulatory requirement and the applicable regulatory citation (GAGAS 3.25 and 3.44 or see 2007 GAGAS 3.04)).**

**Assessment of Threats to Independence - Other Nonaudit Services**

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**PART V Conclusion**

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**10. Summarize the results of the assessment performed in Parts II – IV, as applicable, and provide a statement regarding whether the service can or cannot be provided without impairing independence.**

**NOTE: In the rare circumstances where question 9 was completed and it is concluded that the nonaudit service will be performed because it is required by regulation, a modified GAGAS statement will need to be included in the audit report for any current or future audits for which independence is impaired by the performance of the required nonaudit service. In such cases, the FAO should determine in coordination with the region and Headquarters what steps will be taken to ensure that an appropriately modified GAGAS statement is included in the report for affected audits and those steps should be documented here.**

FAO: \_\_\_\_\_

Prepared By: \_\_\_\_\_ Date: \_\_\_\_\_

Supervisory Review: \_\_\_\_\_ Date: \_\_\_\_\_

The FAO should forward the assessment to the regional office. **After the region has reviewed the FAO's assessment and determined that it is complete and reflects well documented thoughtful professional judgment**, the regional office should forward it to Headquarters, PAS for coordination.

Regional Review By : \_\_\_\_\_ Date: \_\_\_\_\_

HQ PAS Review By : \_\_\_\_\_ Date: \_\_\_\_\_

*The approved form should be included with the documentation for the 49800 service.*