



**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

November 16, 2012  
12-PAS-029(R)

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

**SUBJECT: Audit Guidance on Revisions to Statements of Independence**

**SUMMARY**

The purpose of this MRD is to implement revised Agency policy regarding the statements of independence, to ensure compliance with the Generally Accepted Government Auditing Standards (GAGAS) 2011 Revision.

Auditors and internal specialists will complete the independence training annually and sign an independence statement upon completion. The revisions to the Statement of Independence are to:

- Make it applicable to internal specialists (e.g., industrial engineers, operations research specialists, and attorney-advisors), as well as auditors.
- Reference the GAGAS 2011 Revision sections on independence.
- Require the use of application of the conceptual framework approach to independence to identify and evaluate any threats to the independence of those involved in the audit.
- Provide options for use by the supervisor in reviewing the statement and for documenting the evaluation and mediation of any identified threats.
- Use digital signatures.
- Require auditors and internal specialists to reevaluate their independence upon assignment to an audit or consulting on an audit.

We also are implementing the use of an Audit Specific Independence Determination workpaper to document independence at the audit level and assist documenting compliance with our quality control system and in monitoring compliance with our quality control policies and procedures.

All audit staff and internal specialists should complete the FY 2013 annual training by December 15, 2012. The FY 2013 training incorporates the revised Statement of Independence, and the Statement of Independence will be available as Other Audit Guidance (OAG) upon promulgation of the training. In keeping with the required completion date of the training, the use of the Audit Specific Independence Determination workpaper is effective as of December 15,

PAS 730.3.B.2.4

SUBJECT: Audit Guidance on Revisions to Statements of Independence

2012 for all assignments that begin on or after December 15, 2012. The Audit Specific Independence Determination workpaper will be available as OAG and delivered in APPS packages as of December 15, 2012.

## **BACKGROUND**

GAGAS 3.84 requires the audit organization to document its quality control policies and procedures and communicate those policies and procedures to its personnel. The audit organization also should document compliance with its quality control policies and procedures and maintain such documentation for a period of time sufficient to enable those performing monitoring procedures and peer reviews to evaluate the extent of the audit organization's compliance with its quality control policies and procedures.

GAGAS 3.88 also requires audit organizations to establish, as part of their quality control system, policies and procedures on independence designed to provide reasonable assurance that the audit organization and its personnel maintain independence. Such policies and procedures assist the audit organization to communicate its independence requirements to its staff, and identify and evaluate circumstances and relationships that create threats to independence, and take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.

As a part of DCAA's system of quality control, all auditors have been required to complete a Statement on Independence upon completion of the annual independence training to document compliance with GAGAS independence requirements. In addition, it is DCAA's policy that auditors must notify their supervisors, in writing, if they believe they have or may have an independence impairment. The guidance in this MRD revises Agency policy regarding the statements of independence to ensure compliance with the GAGAS 2011 Revision.

## **GUIDANCE**

### Inclusion of Internal Specialists

The GAGAS 2011 Revision also revised the requirements for assessing the independence of specialists assisting with performance audits. DCAA performs minimal performance audits; however, some of those audits require assistance from internal specialists (e.g., industrial engineers, operation research specialists, attorney-advisors, etc.). GAGAS 6.44 requires auditors to assess the independence of specialists in the same manner as they would for auditors performing work on those audits, which includes identifying threats and applying any necessary safeguards. In addition, when performing a compliance engagement, the nature of the specific compliance requirement may require specialized skill or knowledge in a particular field other than accounting and auditing. For example, in many of our forward pricing audits, DCAA is using an internal specialist to assist with improvement curves. In these circumstances, AT 601.43 requires auditors to follow the relevant performance and reporting guidance in AU

PAS 730.3.B.2.4

SUBJECT: Audit Guidance on Revisions to Statements of Independence

Section 336, *Using the Work of a Specialist*. The AICPA is in the process of replacing AU Section 336, *Using the Work of a Specialist* with AU-C 620, *Using the Work of an Auditor's Specialist*, which implements requirements for assessing the independence of internal specialists.

The application material of AU-C 620 currently provides that the auditor should consider whether the specialist is subject to the firm's quality control policies and procedures, including those pertaining to independence. It indicates that if the specialist is subject to the quality control system, an audit team may rely on the audit organization's system of quality control when performing this assessment; unless it is determined it would be inappropriate to do so. To assure compliance with the GAGAS 2011 Revision, DCAA internal specialists now will be subject to the Agency quality control procedures pertaining to GAGAS independence. Therefore, internal specialists now are required to complete the GAGAS Independence Training and sign a statement of independence.

#### The Statement of Independence

The GAGAS 2011 Revision implements the use of a conceptual framework approach to independence. Under the GAGAS 2011 Revision, auditors should apply the conceptual framework at the audit organization, audit and individual auditor level to identify and evaluate threats to independence. In addition, GAGAS requires auditors to evaluate threats to independence using the conceptual framework when the facts and circumstances under which the auditors perform their work may create or augment threats to independence, such as the start of a new audit or the assignment of new staff to an ongoing audit.

We revised the Statement of Independence to incorporate the GAGAS 2011 Revisions including the new GAGAS references. By signing the statement, the signer is confirming they have read and understand GAGAS Sections 3.02 through 3.26 pertaining to independence, and evaluated threats to their independence related to the contractors under the cognizance of their office as of the date of the statement. Similar to the prior statement of independence, the **signer** will select one of two statements regarding threats to their independence. The first option states they have not identified any threats to their independence. The second option states, except for the threats to independence disclosed to their supervisors, in writing, related to the contractor(s) listed on the statement, they have not identified any threats to independence. Both options state they will reevaluate their independence whenever they are assigned to an audit, requested to consult on an audit, or if facts and circumstances are identified that create threats that may affect their independence. If the reevaluation identifies threats to independence, they immediately will notify their supervisor, in writing, and will execute a new Statement of Independence.

The revised Statement of Independence has three options for use by the **supervisor** when reviewing and signing the statement. In situations where the auditor identified a threat to independence, the auditor will document the threat and the supervisor will discuss the issue with the auditor and determine if the threat is significant and requires the application of safeguards. If safeguards are necessary, the supervisor will document the safeguards applied to reduce the

PAS 730.3.B.2.4

SUBJECT: Audit Guidance on Revisions to Statements of Independence

threat to an acceptable level. If it is determined that the auditor needs to recuse himself or herself from the audit, attach the auditor's recusal letter to the statement. If the supervisor determines the threat is not significant and, therefore, does not require the application of safeguards, the supervisor will document the basis of this conclusion on the statement.

#### The Audit Specific Workpaper

We have created an Audit Specific Independence Determination workpaper documenting independence at the audit level to assist in documenting compliance with our quality control policies and in monitoring compliance with those policies and procedures. The auditor or internal specialist will digitally sign the workpaper only if their reevaluation of independence performed in relation to the audit did not identify any significant threats to independence.

The auditor or internal specialist should sign the Audit Specific Independence Determination workpaper when assigned to a new audit or an in-process audit prior to starting work or consulting on the audit. The independent reference reviewer also should reevaluate their independence in relation to the audit and digitally sign the workpaper prior to beginning the independent reference review (IRR) process. If significant threats are identified and safeguards other than removing the auditor from the assignment cannot be applied then the auditor or internal specialist should not sign the statement and must not work on the audit.

#### Assignments under 2007 GAGAS

The 2011 revision of GAGAS is effective for attestation engagements for periods ending on or after December 15, 2012, and does not permit early implementation. DCAA first will start applying the 2011 GAGAS Revision to audits performed in Calendar Year (CY) 2013, as discussed in MRD 12-PAS-026. 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. The 2007 GAGAS do 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. Therefore, auditors should use the conceptual framework when reevaluating their independence and complete the Audit Specific Independence Determination workpaper for audit assignments beginning on or after December 15, 2012, whether the 2011 or 2007 GAGAS apply to the assignment.

#### **CLOSING REMARKS**

We are in the process of revising APPS to generate the Audit Specific Independence Determination as a part of the administrative working papers. The Statement of Independence and the Audit Specific Independence Determination workpaper will be available as Other Audit Guidance (OAG) on the DCAA Intranet under the "Audit Program, Reports, OAG" menu option.

November 16, 2012  
12-PAS-029(R)

PAS 730.3.B.2.4

SUBJECT: Audit Guidance on Revisions to Statements of Independence

FAOs should direct any questions or concerns to their regional offices. Regional offices may address their questions to Auditing Standards Division (PAS), at (703) 767-3274 or e-mail address: [dcaa-pas@dcaa.mil](mailto:dcaa-pas@dcaa.mil).

/Signed/

Donald J. McKenzie  
Assistant Director  
Policy and Plans

Enclosures

1. DCAA Statement of Independence
2. Audit Specific Independence Determination Workpaper

DISTRIBUTION: E

# Defense Contract Audit Agency

## Statement of Independence

**Background:** Generally Accepted Government Auditing Standards (GAGAS) address auditor independence. Section 3.02 of GAGAS states: “In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.” Independence comprises independence of mind and independence in appearance. Independence of mind is the state of mind that permits the performance of an audit without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism. Independence in appearance is the absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised (GAGAS 3.03).

GAGAS establishes a conceptual framework that auditors should use to identify and evaluate threats to independence when the facts and circumstances under which the auditors perform their work, may create or augment threats to independence. Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised, and on the specific safeguards applied to eliminate the threat or reduce it to an acceptable level. Threats are conditions to be evaluated using the conceptual framework. Threats do not necessarily impair independence. Auditors should apply the conceptual framework at the audit organization, audit and individual auditor level.

Before signing the independence statement and providing it to their supervisor for review, the auditor should identify and evaluate any threats to their independence using the GAGAS conceptual framework approach to independence. The GAGAS conceptual framework and its application are discussed in GAGAS 3.07 through 3.26 and illustrated in GAGAS Appendix II. GAGAS also provides examples of circumstances that create threats to independence in GAGAS A3.02 through A3.09 however the list does not include all circumstances that could create threats and the auditor should consider their unique circumstances in performing the evaluation.

-----

**Instructions:** This statement, which documents compliance with the GAGAS independence standards, should be completed at least annually by all DCAA auditors and internal specialist (e.g. industrial engineers, operations research specialist). This statement is also to be completed by newly hired auditors and internal specialist upon reporting to the Agency. Individuals who believe they may have independence impairment (either of mind or in appearance), not previously disclosed to their supervisor, should immediately notify their supervisor in writing.

Individuals, who experience a situation after signing that they believe impairs or may impair their independence and/or objectivity should immediately notify their supervisor in writing and, execute a new Independence Statement. Any recusal letters submitted by the employee should be attached to this statement.

# Defense Contract Audit Agency

## Statement of Independence

-----

**Statement:** I have read and understand GAGAS Sections 3.02 through 3.26 pertaining to independence and have reviewed the list of contractors under the cognizance of my assigned office or division as of the date of this statement and evaluated threats to my independence related to those contractors.

Check the appropriate box:

- I state that in relation to the contractors under my office's cognizance I have not identified any threats to independence. I will reevaluate my independence whenever I am assigned to an audit or requested to consult on an audit or if my circumstances change. If I identify facts and circumstances that create threats that may affect my independence I will immediately notify my supervisor in writing and execute a new Independence Statement.
  
- Except for the threats to independence described below, I state that I have not identified any threats to independence. I will reevaluate my independence whenever I am assigned to an audit or requested to consult on an audit or if my circumstances change. If I identify facts and circumstances that create threats that may affect my independence, I will immediately notify my supervisor in writing and execute a new Independence Statement.

Describe below, or in additional documents attached to this statement, the threats to your independence. This includes any threats that you previously disclosed to your supervisor that were determined to be significant if the circumstance still exist. If the threats are described in the attached documents, list the contractors to which the threats apply below.

Attach additional documents if necessary:

Date:

Printed Name:

Signature:

---

# Defense Contract Audit Agency Statement of Independence

## Supervisor's Review

Check the appropriate box:

I have reviewed this statement of independence. Information reported indicates the employee has not identified any threats to independence.

I have discussed the employee's potential threat to independence with the employee and as considered necessary, with the FAO manager, regional or headquarters staff. I have concluded, based on the information provided, and the application of the conceptual framework, that the reported threat is not significant and does not require the application of safeguards. The basis for this conclusion is documented below.

Attach additional documents if necessary:

I have discussed the employee's potential threat to independence with the employee, and as considered necessary, with the FAO Manager, regional or headquarters staff. I have concluded based on the information provided, and the application of the conceptual framework, that the threat is significant for the following reasons.

Attach additional documents if necessary:

I have applied the following safeguards to eliminate or reduce the threat to an acceptable level.

Attach additional documents if necessary:

Date:

Printed Name:

Signature:

---

# Audit Specific Independence Determination

**Audit Assignment No.**

**Purpose:** To document that the auditors or internal specialists (e.g., industrial engineers, and operations research specialists) consulting on this engagement are independent from the audited entity as required by Generally Accepted Government Auditing Standards (paragraphs 3.02-3.26).

**Instructions:** This audit summary statement, which documents compliance with the GAGAS independence standards, is to be completed for each assignment and signed by each auditor who is directing, performing audit procedures, or reporting on this audit as a member of the audit team **prior to starting work on the audit**. It should also be signed by internal specialists (e.g., industrial engineers, operation research specialist, etc.) performing as a consultant on the audit **prior to starting work on the audit**.

Because staff are sometimes added to on-going audits, supervisors should ensure that all individuals who are directing, performing audit procedures, or reporting on this audit as a member of the audit team who are performing as a consultant have signed this work paper. For example, an FAO may add additional auditors (e.g. FAO technical specialist) to the audit assignment or may need to consult with an internal specialist (e.g., industrial engineers, and operations research specialists) as the audit progresses.

DCAA policy requires auditors and internal specialists to reevaluate their independence in relation to the specific assignment upon being assigned to an audit or when consulting on an audit. You should only sign this work paper if your reevaluation did not identify any threats to independence in relation to this assignment.

Please sign below to indicate you have evaluated your independence using the GAGAS conceptual framework approach to independence and that you have not identified any threats to independence that would keep you from objectivity directing, performing audit procedures, or reporting on this audit as a member of the audit team or performing as consultant to the audit team.

<u>Date</u>	<u>Name</u>	<u>Title</u>	<u>Signature</u>
<hr/>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>
<hr/>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>
<hr/>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>	<div style="background-color: #cccccc; width: 100%; height: 20px;"></div>

# Audit Specific Independence Determination

## Independent Reference Reviewer

Please sign below to indicate you have evaluated your independence using the GAGAS conceptual framework approach to independence and that you have not identified any threats to independence that would keep you from objectively performing the independent reference review for this assignment

Date

Name

Title

Signature

_____			
-------	-----------------------------------------------------------------------------------	------------------------------------------------------------------------------------	-------------------------------------------------------------------------------------