



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

IN REPLY REFER TO

PPD 730.5.35.1

March 13, 2012  
12-PPD-006(R)

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

**SUBJECT: Audit Guidance on Utilizing Multi-Year Audit Techniques for Incurred Cost Audits**

Auditors should look for opportunities to apply multi-year auditing techniques when performing incurred cost audits at contractors where more than one adequate incurred cost claim is available for audit. Multi-year auditing techniques may increase efficiency and effectiveness in designing and applying audit procedures, while allowing for one set of working papers and one audit report. In most cases, smaller contractor locations provide the greatest potential for applying multi-year auditing techniques. Auditors should not apply multi-year auditing techniques at contractor locations with greater than \$250M in ADV. Multi-year auditing may be employed only where the auditor has determined and documented that the contractor's business and organizational structure for the years being audited has been relatively stable and consistent. For example, a contractor's incurred cost proposals may be considered eligible for multi-year auditing when:

- there were similar type contracts being performed throughout the audit years,
- there have been no significant changes in the contractor's business systems and internal control environment, and
- there have been no significant organizational or operational changes.

Testing of details must be performed in all years in order to obtain sufficient, appropriate evidence to provide a reasonable basis for the conclusions and opinion stated in the report (i.e., opinion on all indirect and direct costs for each audited year). However, the audit approach for each year should be based on the auditor's documented risk assessment and understanding of the contractor's relevant systems/internal controls. For example, the auditor may select an account in one year for the initial testing of details and then adjust (increase or decrease) the risk level and related testing required for that account in the remaining years based on the results of the year tested. Alternatively, the auditor may include sampling a homogeneous population of like transactions across all years for testing of details. Auditors should clearly document their rationale and judgments used for determining the nature, timing, and extent of audit procedures performed.

SUBJECT: Audit Guidance on Utilizing Multi-Year Audit Techniques for Incurred Cost Audits

Auditors may employ audit sampling, judgmental selection, or a combination of these methods to accomplish the audit objectives. If judgmental selection is used, auditors must document in the working papers why the judgmental selection results in adequate audit coverage of the universe to meet the audit objectives. If the auditor is sampling across fiscal years or pools using a single combined sample universe, the auditor must clearly document in the work papers the determination that such a combination results in a homogeneous population. Auditors are reminded that when using statistical sampling, the auditor must ensure that the findings are appropriately evaluated before projecting. For guidance on audit sampling, judgmental selection and evaluation of sample results, refer to CAM 4-600.

For all in-process multi-year assignments, auditors should incorporate any additional procedures into their assignments for each year, as deemed necessary, based on risk and auditor judgment to ensure sufficient appropriate audit evidence is obtained to support the audit opinion, in accordance with GAGAS.

CAM 6-603.6, Multi-year auditing is being changed to reflect this revised guidance. In addition, practical examples on the application of statistical sampling and judgmental selection will be provided in the near future.

The Enclosure to this MRD contains responses to some frequently-asked questions to assist auditors in applying this guidance. FAO personnel should direct questions to their regional POCs, and regional personnel should direct any questions to Policy Programs Division, at 703-767-2270 or e-mail [DCAA-PPD@dcaa.mil](mailto:DCAA-PPD@dcaa.mil).

/Signed/

Kenneth J. Saccoccia  
Assistant Director  
Policy and Plans

DISTRIBUTION: C

Enclosure:

Frequently Asked Questions on Multi-year Auditing

## **FREQUENTLY ASKED QUESTIONS MULTI-YEAR AUDITING TECHNIQUES**

**Question 1:** Will CAM 6-603.6 be revised to clarify whether testing of details is required in each year of the multi-year audit?

**Answer:** Yes, CAM 6-603.6 will be substantially updated with the new guidance. Previously, CAM 6-603.6 contained specific guidance for the performance of transaction testing related to MAARS 10 and 16, which allowed the auditor to limit transaction testing to one year if account balances and conditions were similar for all years and no significant exceptions were identified. Under the revised guidance, auditors are required to perform some testing of details in each year and the level of testing must be based on risk. For example, the auditor may select an account in one year for the initial testing of details and then adjust (increase or decrease) the risk level and related testing required for that account in the remaining years, based on the results of the year tested. Based on risk, the auditor may determine that the account should not be tested in subsequent years and the auditor chooses other higher risk accounts for testing.

**Question 2:** Does a multi-year audit result in one report for each year or a combined report? If combined, under which assignment? Can we set up a 10160 to perform the risk assessment and document detail working papers or should the work be performed under a 10100.

**Answer:** FAOs should issue one report for all years under audit. The audit report number should reflect each year's individual assignment code. The auditor may create the working papers under the 10100 assignment for the latest year under audit. FAOs may choose to use a 10160 sub-activity code to divide significant portions of the multi-year audit into manageable sections.

**Question 3:** What is the limit on the number of years that can be included in one multi-year assignment?

**Answer:** For contractors with less than \$250M in ADV, auditors may include two-to-five fiscal years' incurred cost audits in one multi-year assignment. The number of years should be based on the auditor's risk assessment where the auditor has determined and documented the contractor's business and organizational structure for the years being audited and those years have been relatively stable and consistent. Key elements to be considered include:

- Contract type mix, sales, customer base
- Organizational structure and operations
- Business acquisitions, loss or mergers
- Employee turnover, key management positions and accounting staff turnover
- Number of employees
- Accounting practices, policies and procedures
- Business systems and internal control environment

**Question 4:** Are you precluded from performing multi-year audits if you have prior questioned costs?

## **FREQUENTLY ASKED QUESTIONS MULTI-YEAR AUDITING TECHNIQUES**

**Answer:** No. Prior questioned costs and/or non-compliances should be considered during the overall risk assessment to design appropriate audit procedures for all applicable years to achieve the objectives of the audit.

**Question 5:** What happens if, during the performance of a multi-year audit, the auditor finds the risk assessment conditions that allowed for the use of multi-year auditing techniques was not accurate (e.g., significant increase in the number of employees or changes in the contractor organizational structure.)

**Answer:** If the auditor finds any contractor business or organizational changes that result in unbalanced audit risk among the fiscal years, the auditor should document the conditions and plan and perform a separate audit for each fiscal year.

**Question 6:** What is meant by a homogeneous population?

**Answer:** If the auditor desires to test an indirect account for all years combined, the homogeneity of the costs must be considered and documented. In determining the homogeneity of indirect accounts across years in order to establish the most appropriate sampling method (testing each year separately, including all years in one sampling universe, or stratifying the audit universe by year), a few items in which auditors should consider are:

- (1) Is the account value and/or transaction volume approximately the same across all years?
- (2) Are control and inherent risk approximately the same across all years?
- (3) Have accounting changes occurred within the audited years?
- (4) Has the contractor implemented changes to the accounting system within the audited years?
- (5) Has the contractor changed policies and procedures among audited years?

If the costs are not considered homogeneous across the years, the auditor must create universes by year.

For direct costs, the added complication to multi-year auditing is the existence of multiple contracts. As part of the risk assessment, the FAO should review applicable MAARs, other risk assessment procedures, and other related audits to determine what contracts or cost elements require direct cost testing. In determining if direct costs (by cost estimate) from multiple contracts can be combined into one audit universe for testing through statistical sampling techniques, auditors should consider the following, among other possible issues:

- (1) Are the terms and conditions governing the allowability of costs the same across all contracts?
- (2) Are the policies and procedures affecting the direct cost account to be audited the same across all contracts?

## **FREQUENTLY ASKED QUESTIONS MULTI-YEAR AUDITING TECHNIQUES**

- (3) Will a projection of questioned costs across all contracts in the sampling universe be realistic and reasonable?

**Question 7:** How are questioned costs projected back to the sample universe in a multi-year environment?

**Answer:** When performing multi-year auditing, auditors must ensure findings are appropriately evaluated before projecting questioned costs across contracts and/or across years. This means that auditors must fully evaluate the basis for the questioned costs and determine and document if the issue is contract specific or unique to a particular fiscal year. Non-recurring errors and non-systematic errors are generally not projected to the sample universe. However, if the basis for the questioned costs are the result of a systemic issue affecting more than one contract and/or fiscal year, the auditor must then document an appropriate method for projecting the costs (e.g., allocating the questioned costs based on the relative contribution to the sample universe.) When the sampling universe combines pools or years, the resulting projection of sample results is made to the entire sample universe. The auditor will need to determine the best method of allocating the sample projection back to the individual pools and/or fiscal years. The determination is based on auditor judgment and should not be presented as a statistical projection to the individual pools/years.