

# **DCAAM 7640.1, DCAA Contract Audit Manual**

## **Chapter 2**

### **Auditing Standards**

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## **2-000-Auditing Standards \*\***

### **2-001 Scope of Chapter \*\***

This chapter discusses the auditing standards that apply to DCAA audits. Auditing standards differ from audit procedures. Audit procedures are designed to meet the audit objectives for examining or evaluating the subject matter under audit. Auditing standards relate to conducting engagements to ensure the quality of the audit work performed meets the audit objectives.

## **2-100 Section 1 – Auditing Standards and DCAA Audits \*\***

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

a. DoD Instruction 7600.02, “Audit Policies,” incorporates the [Government Auditing Standards](#) (GAGAS) issued by the Comptroller General of the United States Government Accountability office (GAO). These standards are commonly referred to as GAGAS or the “Yellow Book” (YB) interchangeably. As prescribed in DoD Directive 5105.36 “Defense Contract Audit Agency” DCAA provides contract audit services for all of DoD and performs audits in accordance with GAGAS.

b. GAGAS incorporates the American Institute of Certified Public Accountants (AICPA) auditing standards. Therefore, in order to comply with GAGAS, DCAA auditors must also comply with relevant AICPA standards. The AICPA’s Statement on Standards for Attestation Engagements (SSAE) are codified as [AICPA AT-C standards](#) and apply to attestation engagements, including agreed-upon procedures engagements. SSAE 18 is applicable to attestation engagements, and SSAE 19 is applicable to agreed-upon procedure engagements.

c. The current revision of GAGAS was issued in July 2018 and is available on the [GAO web site](#). The 2018 revised standards are applicable for attestation engagements for periods that end on or after June 30, 2020, and for performance audits that begin on or after July 1, 2019.

- Apply the 2011 GAGAS standards for incurred cost audits covering fiscal years that end before June 30, 2020.
- Apply the 2018 GAGAS standards for incurred cost audits covering fiscal years that end on or after June 30, 2020, for all performance audits, and for all other types of engagements that begin on or after July 1, 2020. The date of the initial acknowledgement letter will be used to determine when the engagement begins.

d. All engagements begin with objectives, and the objectives determine the type of engagement to be performed and the auditing standards to be followed.

- For attestation and agreed-upon procedure engagements the standards for 2018 GAGAS are located in chapter 7 and the standards for 2011 GAGAS are located in chapter 5 (see 2-300 and 2-400). [SSAE 18](#) and [SSAE 20](#) are applicable for attestation engagements and SSAE 18 and [SSAE 19](#) are applicable to agreed-upon procedure engagements.
- The 2018 GAGAS standards for performance audits are located in chapters 8 and 9 of the 2018 YB (see 2-500 for discussion of performance audit fieldwork standards, and 2-600 for discussion of performance audit reporting standards).
- For engagements performed in accordance with 2018 GAGAS, chapters 1 through 5 apply to all engagements (see 2-200).

- For engagements performed in accordance with 2011 GAGAS, Chapters 1 through 3 apply to all engagements (see 2-200).
- Auditors should also consider any applicable GAO issued [GAGAS interpretive guidance](#).

e. DCAA uses the terms examination and audit interchangeably when referring to attestation–level examination engagements.

f. Fieldwork and reporting requirements for attestation engagements and performance audits are implemented through CAM guidance, supplemented by the standard audit programs and the audit report shells delivered by CaseWare.

**2-102 AICPA Attestation Standards \*\***

a. For attestation engagements, unless specifically excluded or modified by GAGAS, GAGAS incorporates the AICPA's Statements on Standards for Attestation Engagements (SSAE). [SSAE No. 18](#) establishes requirements and provides application guidance for performing and reporting on examination and agreed-upon procedures engagements. The SSAE 18 sections that are applicable to work performed by DCAA are codified by the AICPA as AT-C 105 Concepts Common to All Attestation Engagements, AT-C 205 Examination Engagements, AT-C 215 Agreed-Upon Procedures, and AT-C 315 Compliance Attestation.

b. Attestation engagements are performed as examinations or through agreed-upon procedures in order to report on a subject matter that is the responsibility of another party. It is important to identify the assertion or subject matter being reported on (e.g., incurred cost proposal, price proposal, a contractor’s business system; where the assertion is obtained from; criteria, such as contract terms, legislation, or regulations).

**2-102.1 Types of Attestation Engagements \*\***

The three types of attestation engagements each provide for different levels of assurance in relation to the auditor's opinion or conclusions, as reflected in the table below.

<b><u>Type of Attestations</u></b>	<b><u>Level of Assurance</u></b>	<b><u>Type of Report Statement</u></b>
<b>Examination</b>	High-Positive	Unqualified, Qualified, Adverse, or Disclaimer of Opinion
<b>Review</b>	Moderate-Negative	Disclaimer of Opinion
<b>Agreed-Upon Procedures</b>	None	Disclaimer of Opinion

a. Examinations provide a high level of assurance and express the audit conclusion in the form of an opinion (stated as positive assurance) on whether the subject matter is in conformity with the criteria in all material respects. To achieve a high level of assurance, sufficient appropriate evidence must be obtained in order to restrict attestation risk to a low level.

b. Reviews. DCAA does perform review engagements.

c. Agreed-upon procedure engagements are substantially less in scope than an examination and report on the results of specific procedures performed without providing an opinion or conclusion (includes a statement disclaiming an opinion). 2018 GAGAS 7.78 – 7.85, and AICPA’s AT-C 215 and SSAE 19 provide requirements and guidance for conducting agreed-upon procedures engagements.

## **2-102.2 Types of Report Statements-Unqualified, Qualified, Adverse Opinion and Disclaimer of Opinion \*\***

a. When an attestation examination engagement discloses no material findings to be reported, and the auditor followed all applicable GAGAS requirements, the report opinion will be unqualified.

b. When an examination discloses that the assertion is not in conformity with the criteria (i.e., the auditor has reservations about the assertion (see 2-402.3), has findings of material noncompliance, etc.), the auditor must issue either a qualified or adverse opinion, depending on the materiality of the departure from the criteria (e.g., considering the nature and significance of the audit exception(s)).

c. If the auditor did not comply with all applicable GAGAS requirements (e.g., the auditor was not able to perform all the procedures necessary in the circumstances), Either a qualified opinion or disclaimer of opinion will be issued, depending on the significance of the potential effects of the departure from the requirements.

d. A qualified opinion provides assurance that, except for the effects of the matter to which the qualification relates, the subject matter or the assertion materially complies with the established criteria (e.g., FAR/DFARS). A qualified opinion is expressed when:

(1) There are significant reservations about the engagement, such as a lack of sufficient evidence, significant scope limitations, or departures from GAGAS, and the auditor concludes an unqualified opinion cannot be issued. Additionally, the auditor has determined that a disclaimer of opinion is not warranted,

(2) There are significant reservations about the subject matter or assertion demonstrating that the subject matter contains significant departures from the established criteria, and the auditor has determined that an adverse opinion is not warranted.

e. An adverse opinion states that the degree of nonconformity of the subject with the criteria is significant. To arrive at the decision to express an adverse opinion (rather than a qualified opinion), the auditor must consider the materiality and pervasiveness of the departures from the criteria, with consideration that lower materiality levels may be appropriate because of Government accountability and the visibility and sensitivity of Government programs (GAGAS 7.06). An adverse opinion should be expressed only when the auditor has performed an audit of sufficient scope to meet the audit objectives.

f. A disclaimer of opinion is issued when scope restrictions or departures from GAGAS requirements are so significant that the limitations on the scope of the examination do not enable the auditor to form an opinion. A scope restriction may be imposed by the contractor, the requestor, or by other circumstances, such as the timing of the work or the inability to obtain sufficient evidence (see [10-208.5](#) preparation and distribution of audit reports).

g. When the auditor performs an agreed-upon procedures engagement (see [14-1000](#) application of agreed upon procedures), the resulting report must disclaim an opinion providing no level of assurance due to the scope of the engagement being limited to only the procedures agreed upon by the specified parties.

### **2-102.3. Converting Another Form of Engagement to an Agreed-Upon Procedures Engagement \*\***

a. An attestation examination engagement may not be converted to an application of agreed-upon procedures merely to avoid disclosing a scope restriction.

b. An examination may, under certain circumstances, be converted to an agreed-upon procedure engagement. This is typically due to the requestor's desire to change to an agreed-upon procedure engagement resulting from changes in circumstances that affect the requestor's requirements, or a misunderstanding about the nature of the original services agreed-to or lack of awareness that alternative services were available.

c. Before an attestation examination engagement is converted to an agreed-upon procedures engagement, consider the following:

- (1) Are the procedures already performed as part of an examination appropriate for inclusion in an agreed-upon procedures engagement?
- (2) Is the rationale for changing to an AUP engagement sound?
- (3) How much additional effort is required to complete the examination engagement?  
Is the original engagement substantially complete or is the effort to complete relatively insignificant?

d. When converting to an AUP engagement, the auditor will issue a revised acknowledgement memorandum to the requestor specifying the scope of engagement and the procedures to be performed, and obtain an acknowledgement from the requestor that the procedures are appropriate for the intended purposes. The AUP report should not reference the original engagement or document that the engagement was changed from an examination engagement.

### **2-104 RESERVED**

### **2-105 Stating Compliance with Generally Accepted Government Auditing Standards (GAGAS 2.16 – 2.23, and 9.03 – 9.05) \*\***

a. DCAA reports must include a statement of compliance with GAGAS.

b. When an audit is conducted in accordance with GAGAS, the report should include an unmodified GAGAS compliance statement. An unmodified statement is used when auditors complied with:

- (1) Unconditional and applicable presumptively mandatory GAGAS requirements, or
- (2) Unconditional requirements with departure from applicable presumptively mandatory requirements, when the justification for any departures are documented and the alternative procedures achieved the intent of the requirements through other means.

c. If GAGAS requirements are not complied with, perform the following:

- (1) assess the significance of the noncompliance to the audit objectives;
- (2) document that assessment and the reasons the requirement was not followed, whether alternative procedures were performed to meet the intent of the requirement, and
- (3) determine the appropriate statement of GAGAS compliance for the report. This

determination is a matter of professional judgment and is affected by the significance of the requirement(s) not followed in relation to the audit objectives.

d. When all the applicable standards are not complied with during the audit, the statement of compliance with GAGAS should be modified depending on the significance of the departure (see 2-402.3a) as follows:

(1) The auditor performed the engagement in accordance with GAGAS, except for specific applicable requirements that were not followed, or

(2) Because of the significance of the departure(s) from the requirements, the auditor was unable to and did not perform the engagement in accordance with GAGAS.

e. Other situations that require use of a modified statement of compliance with GAGAS include scope limitations, such as restrictions on access to records, restriction to officials or other individuals needed to conduct the audit, time constraints that did not permit completing all necessary audit procedures, etc.

f. When a modified statement of compliance with GAGAS is used, the report should disclose the requirement(s) not followed, the reason for the departure, the impact of not following the requirements and how the departure affects the audit results and assurance provided. This information is included in WP A and in the “Basis of Opinion” section of the audit report (see [10-208.4](#) preparation and distribution of audit reports).

#### **2-106 Nonaudit Services GAGAS 3.64 – 3.106 \*\***

a. DCAA does not provide nonaudit services to the entities we audit and the discussion in GAGAS 3.64 – 3.106 is not applicable to DCAA. DCAA does, however provide advisory services to our customers, which could cause impairment to independence, or give the appearance of an impairment. To avoid these risks of impairment to independence, auditors will not participate as team members of Integrated Product Teams (IPT), which typically involve teaming with the contractor to develop a proposal. Auditors will also not provide direct input to contractors to recommend revisions to the contractor’s products, such items as draft proposals, draft policies and procedures, draft CAS disclosure statements or other draft contractor assertions. Such activities could result in significant self-review or management participation threats.

#### **2-107 Communication With Auditee \*\***

a. Auditors must exercise caution when providing input and feedback on contractor submissions to avoid giving the appearance of impairment, or actually becoming impaired. Feedback provided to the contractor should be limited to what the contractor is required to do (for example, cite the contract term or FAR or DFARS criteria with which they need to comply with, general information for what is required for an adequate proposal, general discussion of the proposal adequacy checklist in [DFARS 252.215-7009](#)), or explaining the [FAR 15.408](#) (Table 15-2) requirements for adequate cost or pricing data).

b. See also [4-102](#) (coordination with contractor and government contract administration personnel) and [4-300](#) (conferences with the contractor on audit plans and results) for additional guidance on communication with the contractor during the audit process.

## **2-108 Advisory Services \*\***

a. DCAA provides services other than audits or attestations to other federal government agency officials with cognizance over the contractor, we do not provide any services to the audited entities. DCAA advisory services are not the same as the nonaudit services discussed in GAGAS 3.64–3.106. The nonaudit services discussed in GAGAS are related to services provided by the auditor to the audited entity. Services DCAA provides that are not audits and attestation examinations are not performed in accordance with GAGAS.

b. Services other than audits or attestation engagements performed by DCAA are advisory services. An advisory service is not conducted in accordance with GAGAS, does not provide an audit opinion, and provides no level of assurance on the subject matter.

c. The auditor should clearly communicate to the requestor that the service is not an audit or attestation examination performed under GAGAS, does not provide an opinion on the subject matter overall, and will provide no level of assurance over the subject matter. Memorandums with the results of an advisory service performed by the FAO must include a statement that contains the following information:

*The scope of work performed does not constitute an audit or attestation engagement under generally accepted government auditing standards.*

Advisory services are discussed in more detail in 2-203.4.

## **2-200 Section 2 – General Standards \*\***

### **2-201 Introduction \*\***

This section discusses the general standards in GAGAS that apply to all types of engagements performed in accordance with GAGAS. These standards relate to competence, independence, professional judgment, the organization’s system of quality controls, and external peer reviews. DCAA auditors must also comply with the Standards of Conduct contained in the Joint Ethics Regulations ([DoD Manual 5500.07-R](#)).

### **2-202 Competence (GAGAS 4.02 – 4.15) \*\***

a. GAGAS requires that those assigned to each audit collectively possess adequate professional competence to address the audit objectives and perform the work (GAGAS 4.02), and that prior to beginning work effort, each auditor possesses the competence to perform his or her assigned role (GAGAS 4.03). Competence for each engagement must be assessed at both the individual auditor, and engagement team levels. Each individual auditor must possess the competency needed for his or her assigned role.

b. Competence is the knowledge, skills, and abilities, obtained from education and experience, necessary to conduct the engagement. Competence enables auditors to make sound professional judgments and includes possessing the specific knowledge about GAGAS as well as the technical knowledge and skills necessary for the assigned role and the type of work being performed. DCAA policies and procedures for staff competence are an integral element of the DCAA quality control system and are discussed further in 2-S103.2.

c. The standards do not exclude the use of auditors in a training status, as long as trainees are assigned duties commensurate with their experience, have the competence necessary to perform their assigned role, and are adequately supervised.

## **2-202.1 Technical Knowledge (GAGAS 4.07 – 4.08) \*\***

a. Auditor proficiency in the knowledge, skills and abilities needed to conduct the engagement in accordance with GAGAS help ensure the engagements are performed in compliance with the GAGAS requirements. This technical knowledge includes possessing a sufficient understanding to be able to proficiently apply:

- GAGAS, applicable to the type of engagement,
- Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the engagement, such as:
  - Federal Acquisition Regulation and applicable Supplements
  - Contract terms and conditions
  - AICPA SSAE 18
- Techniques, tools, and guidance related to professional expertise applicable to the work being performed. This includes skills necessary to perform the actual audit effort, such as:
  - The ability to effectively and clearly communicate, both orally and in writing,
  - Specialized audit methodologies or analytical techniques, such as understanding and applying statistical or non-statistical sampling, regression analysis, and data analytics,
  - Understanding relevant information technology,
  - Understanding of the 5 components of internal control

b. When assistance from specialists in other disciplines, such as DCAA legal, or the contracting officer's project management team (e.g., engineering or construction specifications, labor hours) is needed, make arrangements as early in the engagement as possible to help ensure the technical assistance report can be provided timely for consideration in audit findings and report opinion. See Appendix B for guidance in obtaining technical assistance.

## **2-202.2 Continuing Professional Education (GAGAS 4.16 – 4.53) \*\***

a. GAGAS requires auditors to be competent when performing GAGAS engagements and has established a minimum number of training hours auditors must complete for continuing professional education (CPE). Continuing education contributes to auditors being competent to plan and perform the engagement in compliance with GAGAS.

b. Auditors who plan, direct, perform engagement procedures for, or report on an engagement conducted in accordance with GAGAS, should develop and maintain their professional competence by completing at least 80 hours of CPE during each two-year reporting period. At least 20 CPEs must be completed each year. Within the 80 hours, 24 hours should be in subject matter directly related to the government environment.

c. Each auditor is responsible for ensuring required CPEs are obtained to maintain their competency. Field audit office staff, Headquarters, the regions, and the CADs share responsibility for ensuring staff maintain competency through appropriate CPEs. The specific

responsibilities of all parties are defined in the DCAA Personnel Management Manual, DCAAM 1400.1.

**2-203 Independence (GAGAS 3.17 – 3.63 and 3.107 – 3.108) \*\***

a. GAGAS states that in all matters relating to the audit work, each individual auditor must be independent from the audited entity. GAGAS Chapter 3 establishes a conceptual framework to identify and evaluate threats, apply safeguards, and document the evaluation of independence.

b. Auditors and audit organizations maintain independence to ensure their audit opinions, findings, conclusions, judgments, and recommendations are impartial and are viewed as impartial by reasonable and informed third parties. To comply with the independence standards, an auditor should avoid situations that could lead reasonable and informed third parties to conclude that the auditor is not independent and thus not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work. Each auditor has an obligation to refrain from entering into any relationship (financial, social, or other) with contractors and contractor employees that would impair, or give the appearance of impairment, his or her independence or objectivity or reflect discreditably on him/her, the Agency or DoD.

c. Auditors should be independent from the contractor during any period that falls within the period of the subject matter of the audit and during the period of the professional engagement. The engagement begins either when the initial acknowledgement letter is issued to the audit requestor or the audit notification letter is sent to the cognizant government authority (e.g., ACO), or when work begins on the audit, whichever is earlier. However, the period of professional engagement does not necessarily end with the issuance of a report and recommence with the beginning of the next audit. The period of professional engagement lasts the entire duration of the professional relationship, which for recurring audits could cover many periods.

d. GAGAS requires the audit organization's quality control system to establish policies and procedures to address independence. DCAA has established policies and procedures to assist the audit staff to identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. Refer to 2-S103.1 for the Agency's policies and procedures on the documentation of independence considerations, and the actions to take when a threat to independence is identified before work is performed on an audit, during an audit, and after report issuance.

**2-203.1 Conceptual Framework Approach to Independence – Overview (GAGAS 3.26 – 3.51) \*\***

a. The conceptual framework assists auditors in maintaining both independence of mind and independence in appearance (Refer to GAGAS 3.21 for definitions of independence of mind and in appearance) and allows auditors to identify and address threats to independence that result from activities that are not specifically prohibited by GAGAS. The conceptual framework should be applied at the audit organization level, the engagement level, and to individual auditors to:

- (1) identify threats to independence;
- (2) evaluate the significance of the threats identified both individually and in the aggregate; and

(3) apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level. Auditors should conclude that independence is impaired if no safeguards have been effectively applied to eliminate an unacceptable threat or reduce it to an acceptable level.

b. Certain events require auditors to evaluate threats to independence, such as the start of a new audit; assignment of new staff to an ongoing audit; and providing an advisory service. However, many different facts and circumstances, or combination of facts and circumstances, can result in threats to independence or increase the significance of threats to independence. Auditors should use professional judgment to determine whether other events in addition to those stated above warrant evaluation using the conceptual framework.

c. Auditors should reevaluate threats to independence, including any safeguards applied, whenever the audit organization or the auditors become aware of new information or changes in facts or circumstances that could affect whether a threat has been eliminated or reduced to an acceptable level.

### **2-203.2 Conceptual Framework-Identifying Threats to Independence \*\***

a. Threats to independence are facts and circumstances that **could** impair independence, but do not necessarily impair independence. Threats to independence may be created from a wide range of relationships and circumstances. Circumstances that result in threats to independence in one category may result in threats in other categories as well. The GAGAS conceptual framework approach to independence contains the following broad categories of threats to independence to use when identifying and evaluating threats.

(1) Self-interest threat-the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior,

(2) Self-review threat-the threat that an auditor or audit organization that has provided advisory services will not appropriately evaluate the results of previous judgments made or services performed as part of the advisory services when forming a judgment significant to an audit,

(3) Bias threat-the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective,

(4) Familiarity threat-the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship or that of an immediate or close family member, will lead an auditor to take a position that is not objective,

(5) Undue influence threat-the threat that external influences or pressures will impact an auditor's ability to make independent and objective judgments,

(6) Management participation threat-the threat that results from an auditor taking on the role of management or otherwise performing management functions on behalf of an entity undergoing an audit, and

(7) Structural threat-the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited will impact the audit organization's ability to perform work and report results objectively.

### **2-203.3 Conceptual Framework – Evaluating the Significance of Identified Threats and Applying Safeguards \*\***

a. Auditors should determine whether identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level, considering both qualitative and quantitative factors to determine the significance of a threat. Threats should be evaluated both individually and in aggregate, as threats can have a cumulative effect on auditors' independence.

b. When auditors determine that threats to independence are not at an acceptable level, the auditors should determine whether appropriate safeguards can be applied to eliminate the threats or reduce them to an acceptable level.

c. A threat to independence is not at an acceptable level if it either (1) could impact the auditor's ability to perform an audit without being affected by influences that compromise professional judgment or (2) could expose the auditor or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or a member of the audit team, had been compromised.

d. Safeguards are actions or other measures, individually or in combination, that auditors and audit organizations take that effectively eliminate threats to independence or reduce them to an acceptable level. Using the conceptual framework, safeguards are applied that address the specific circumstances under which threats to independence exist. In some cases, multiple safeguards may be necessary to address a threat. GAGAS provides a list of safeguards that may be effective under certain circumstances. The list cannot provide safeguards for all circumstances, but provides a starting point for evaluating identified threats to independence and considering what safeguards could eliminate or reduce the threat to an acceptable level.

Examples of safeguards include:

(1) consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor,

(2) involving another audit organization to perform or re-perform part of the audit,

(3) having a professional staff member who was not a member of the audit team review the work performed, and

(4) removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence.

f. Not all safeguards identified in GAGAS pertain to DCAA; for example, the safeguards included in GAGAS 3.57 – 3.58 relate to the audited entity's internal audit organization. Since DCAA performs audits for third parties, not for the audited entity (contractor), these safeguards would not be applicable for DCAA.

### **2-203.4 Independence Impairments \*\***

a. Certain conditions may lead to threats that are so significant they cannot be eliminated or reduced to an acceptable level through the application of safeguards, resulting in impaired independence. DCAA policy is that an auditor with an independence impairment will not work on affected assignments or perform advisory services that could impair independence. Under these conditions, the auditor will complete the [Memorandum for Notice of Recusal](#), which is

available on the [DCAA Ethics webpage](#).

b. Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise the auditor's professional judgment or create the appearance that the auditor's integrity, objectivity, or professional judgment may be compromised. It also depends on the circumstances and the specific safeguards applied to eliminate the threat or reduce it to an acceptable level.

c. GAGAS requires the audit organization's quality control system to establish policies and procedures to address independence. DCAA has established policies and procedures to assist the audit staff to identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. Refer to 2-S103.1 for the Agency's policies and procedures on the documentation of independence considerations, and the actions to take when a threat to independence is identified before work is performed on an audit, during an audit, and after report issuance.

#### **2-203.5 Documentation Requirements (GAGAS 3.107 – 3.108 & 5.08 – 5.11) \*\***

a. The GAGAS quality control and assurance standards require auditors to prepare appropriate documentation of threats to independence and safeguards applied in response to those threats. Auditors will use the Agency's Documentation of GAGAS Independence Threats template to comply with the GAGAS requirement to document threats to independence and safeguards applied, and will use the [Memorandum for Notice of Recusal](#) to communicate situations where appropriate safeguards cannot be applied to reduce or mitigate the threat risk to an acceptable level.

b. DCAA policies and procedures (refer to 2-S103.1b(1)(f)) requires auditors and internal specialist to reevaluate their independence in relation to each specific audit they perform work or consult on. If no threats are identified, the auditor or internal specialist is required to complete the Audit Specific Independence Determination work paper to document they have not identified any threats to independence in relation to the specific assignment. If the reevaluation identified threats, the procedures in 2-S103.1b(2) and 2-S103.1b(4) should be followed.

c. Each auditor that is required to be independent must provide a retrospective written affirmation that the auditor complied with DCAA's policies and procedures on independence (GAGAS 5.11). The written affirmation must be obtained at least annually.

#### **2-203.6 Government Auditors and Audit Organization Structure \*\***

DoD Directive 5105.36 (see [Supplement 1-1S1](#)) established DCAA as an independent agency of the DoD, and is responsible for performing contract audits for the Department of Defense. DCAA has been organizationally positioned within the DoD to ensure independence from other DoD components involved in the acquisition process. DCAA does not perform audits of other DoD entities which permits DCAA to function in an independent, objective manner in providing contract audit services.

#### **2-203.7 Independence Considerations When Performing an Advisory Service \*\***

a. GAGAS recognizes a variety of circumstances, or combinations of circumstances, relevant to identifying threats to independence. In addition to applying the GAGAS conceptual framework for independence to attestation examinations and performance audits, it can also be

applied when we are requested to provide advisory services. Identifying and evaluating threats and applying safeguards for advisory services is no different from the process used in applying the conceptual framework for attestation engagements and performance audits.

b. To avoid situations that may result in impairment to independence, DCAA auditors only perform advisory services that will not impair independence.

c. Advisory services are defined in the Activity Code Matrix and Activity Code Definitions in the DMIS User Guide. Advisory services should only be performed if they fit into one of the activity codes designated as an advisory service. The scope of any advisory service to be performed should fit within the parameters described in the DMIS definition for the particular activity code. When determining the appropriate type of assignment that should be established to meet a requestor's needs, auditors should reference the DMIS User Guide definitions to ensure the proper activity code is selected for attestation engagements or requested advisory services.

d. If the requested service does not fit into one of the established advisory services activity codes, the assignment may be established under the 49800 activity code, Other Advisory Services. No effort should be performed under the 49800 activity code until the FAO has applied the GAGAS conceptual framework for independence, using the "Other Advisory Services-Assessment of Threats" template, and determined that providing the advisory service does not create significant threats to independence with respect to current or future audits. The evaluation of whether the advisory service causes an impairment to independence should consider the advisory service individually as well as in the aggregate with other services provided. FAOs do not need to perform this assessment for advisory services performed under other DMIS activity codes designated as advisory services, as that documentation is maintained at the Agency level.

e. Advisory services are not performed in accordance with GAGAS, any correspondence regarding such services should include a statement to that effect (see 2-108).

f. FAOs should prepare and maintain documentation of advisory services performed. DCAA routinely performs some assignments as advisory services that have formal documentation packages generated by CaseWare that provide for sufficient documentation of the services (e.g., evaluation of final vouchers). However, when an FAO performs advisory services that do not have formal CaseWare packages, the FAO should prepare and maintain documentation with sufficient information on the advisory services to enable an experienced auditor with no previous connection to the assignment to understand the nature and scope of the work performed. 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 product provided.

g. FAOs should file documentation for work performed under activity codes designated as advisory services in CaseWare in the assignment folder based on the descriptions and guidance in [DCAAM 5015.1](#), Records and Information Management Manual. For documentation related to FLA services (activity codes 30100, 30300, and 30550), activities related to investigative support, Form 2000 and Board of Contract Appeals cases (activity codes 48600, 48610, and 49300), and the processing of public vouchers (activity code 41500), the applicable organizations should follow their current filing practices.

## **2-204 Professional Judgment (GAGAS 3.109 – 3.177 and AT-C 105.43 – 104.45) \*\***

a. Professional judgement is used throughout the audit process. Auditors must use professional judgment in planning and performing audits and attestation engagements and in reporting the results.

b. Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care includes acting diligently in accordance with applicable professional standards and ethical principles. Attributes of professional skepticism include a questioning mind and, awareness of conditions that may indicate possible misstatement owing to error or fraud, and a critical assessment of evidence. Professional skepticism includes being alert to evidence that contradicts other evidence obtained or information the brings into question the reliability of documents or responses to inquiries to be used as evidence. Further, it includes a mindset in which auditors assume that management is neither dishonest nor of unquestioned honesty. Auditors may accept records and documents as genuine unless they have reason to believe the contrary. Auditors may consider documenting procedures undertaken to support their application of professional skepticism in highly judgmental or subjective areas under audit.

c. Using professional judgment is important to auditors in carrying out all aspects of their professional responsibilities, including following the independence standards and related conceptual framework; maintaining objectivity and credibility; assigning competent audit staff to the engagement; defining the scope of work; evaluating, documenting and reporting the results of the work; and maintaining appropriate quality control over the engagement process.

d. Professional judgment and competence are interrelated because judgments made depend on the auditor's competence. Using professional judgment is important in determining the necessary level of understanding of the engagement subject matter and the related circumstances. This includes considering whether the audit team's collective competence is sufficient to assess the risks that the subject matter contain a significant misstatement or inaccuracy.

e. Professional judgment is required to determine the type of engagement or service to be performed, establishing the audit scope, assessing the level of audit risk, designing the methods and procedures to be used to evaluate the subject matter. The auditor must understand the purpose of the audit and the scope of audit necessary to meet the audit objectives, and remain mentally alert and questioning while performing in all phases of the engagement, including assessing risk, performing tests and procedures to evaluate the subject matter, and in reporting the audit results.

f. Professional judgment may be required for collaborating with other stakeholders, specialists, and management in the audit organization. For example, professional judgment is necessary in planning the audit when determining if specialist assistance is needed to obtain sufficient appropriate audit evidence.

g. Auditors must document their rationale for decisions made based on professional judgment related to matters that are significant to the engagement (e.g., assessing sufficiency of evidence, determining areas of risk, procedures designed to address audit risk, conclusions reached, etc.). This includes developing documentation that is sufficient to permit a third-party reviewer (e.g., the IRR reviewer or the DoD OIG) to understand the rationale for the decisions reached from reviewing the documentation. Auditors should ensure the documentation includes information that is inherent to the audit team but is an integral part of the rationale for reaching a conclusion

(e.g., long experience with the contractor makes some knowledge “common knowledge” among the audit team, but if an outside reviewer would not understand the rationale without this “common knowledge”, then the documentation should also include the “common knowledge”).

h. Professional judgment is crucial in determining the sufficiency and appropriateness of evidence obtained to support the findings and conclusions and any recommendations reported.

i. GAGAS places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing GAGAS engagements, it does not, however, imply unlimited responsibility or infallibility on the part of the individual auditor or audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud; an audit conducted in accordance with GAGAS may not detect a material misstatement or significant inaccuracy or noncompliance of provisions of contracts or grant agreements or abuse. Professional judgment does not mean eliminating all possible limitations or weaknesses associated with a specific audit, but rather identifying, considering, minimizing, mitigating, and clearly explaining them.

### **2-205 Quality Control and Assurance (GAGAS Chapter 5) \*\***

a. Each audit organization performing GAGAS engagements must establish a system of quality control designed to provide reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements and have an external peer review at least once every three years. DCAA’s system of quality control encompasses the Agency’s leadership and places emphasis on performing high-quality work.

b. Key elements of the Agency’s quality control system are described throughout this manual and summarized in 2-S10. The system is also documented in the Agency's charter, regulations, instructions, personnel management manual, etc. Agency managers and supervisors serve as focal points for assuring that policies and procedures are properly applied. Procedures are in place to promote feedback from the field ([single-source suggestion program](#)), and for periodic vulnerability assessments and internal reviews.

c. The external peer review must be conducted by reviewers that are independent of the organization being reviewed. The peer review team evaluates if the organization's system of quality control provides reasonable assurance that the organization is in compliance with professional standards.

d. Auditors should be mindful that any engagement could be selected for review during an external peer review process and ensure that documentation is sufficient to allow the external reviewer to understand the nature of the engagement and how the planned and performed procedures obtained sufficient evidence to support the audit report opinion and findings. This documentation should refer to detailed working papers that support findings, and descriptions of rationale when professional judgment was required to arrive at a conclusion. The external peer reviewer should be able to understand the audit objectives, what was done to meet those objectives, and how the working papers demonstrate the objectives were met, without the external reviewer needing to obtain significant explanations or clarifications in order to follow the work performed or understand the basis for decisions and conclusions.

## **2-300 Section 3 – Standards for Attestation Engagements (GAGAS Chapter 7 and Statement on Standards for Attestation Engagements (SSAE) \*\***

### **2-301 Introduction \*\***

This section provides information for conducting attestation engagements in accordance with professional auditing standards.

### **2-302 Applicability of AICPA Statement on Standards for Attestation Engagements (SSAE) (GAGAS 2.11 – 2.15, AT-C 105, AT-C 205, AT-C 315) \*\***

GAGAS incorporates the AICPA SSAE 18 by reference. Therefore, attestation engagements must be performed using GAGAS and the AICPA [Statements on Standards for Attestation Engagements No. 18](#) (SSAE 18). SSAE 18 is comprised of 9 sections, 4 of which are applicable to DCAA engagements:

[AT-C Section 105](#) Concepts Common to All Attestation Engagements, contains concepts that are relevant to all DCAA engagements.

[AT-C Section 205](#) Examination Engagements, contains concepts for attestation examination engagements.

[AT-C Section 215](#) Agreed-Upon Procedures Engagements, as amended by [SSAE No. 19](#) contains concepts for agreed-upon procedures engagements.

[AT-C Section 315](#) Compliance Attestation, contains performance and reporting requirements and application guidance for engagements that include evaluating compliance with laws and regulations.

### **2-303 Concepts Common to All Attestation Engagements (AT-C 105) \*\***

a. All DCAA audit engagements must be adequately planned and properly supervised to comply with professional standards and applicable legal and regulatory requirements. Engagements must be planned and performed to obtain sufficient appropriate evidence that provide a reasonable basis for conclusions expressed in the report.

b. GAGAS requirements for planning and performing attestation examination engagements and agreed-upon procedures engagements that incorporate by reference specific sections of SSAE 18.

c. SSAE 18 defines criteria as the benchmark used to measure or evaluate the subject matter. Suitable criteria are required for reasonably consistent measurement or evaluation of subject matter within the context of professional judgment. The suitability of criteria is context-sensitive, that is, it is determined in the context of the engagement circumstances (AT-C 105.10 and 105.16).

d. The auditor must have 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 exhibit all of the following attributes (AT-C 105.A42):

- (1) Relevance – Criteria are relevant to the subject matter.
- (2) Objectivity – Criteria are free from bias.
- (3) Measurability – Criteria permit reasonably consistent measurements, qualitative or

quantitative, of the subject matter.

(4) Completeness – Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter.

### **2-303.1 Professional Skepticism and Professional Judgment (GAGAS 3.109 and AT-C 105.43-.45) \*\***

Professional skepticism and professional judgment are crucial to performing a GAGAS engagement. See 2-204 for more information.

### **2-303.2 Adequate Planning (AT-C 205.11 – 205.18) \*\***

a. Attestation engagements should be planned and performed to comply with professional standards and applicable legal and regulatory requirements.

b. Before beginning an engagement, it is essential to coordinate with contracting officials requesting the audit or those responsible for dispositioning findings and acting on recommendations. The auditor needs to understand the contracting officer/requestor's needs and/or specific concerns, and be familiar with contractual, regulatory, or other factors pertinent to the engagement in order to determine the type of engagement to be performed.

c. The understanding with the requestor should include reaching an agreement on the objectives of the engagement, responsibilities of the parties, any limitations of the engagement, anticipated time-frame for completing the engagement, and how the results will be conveyed (i.e., through an audit report, memorandum, etc.). Communications with the requestor demonstrating the auditor's understanding with requestor must be documented in the working papers, preferably through a written communication with the appropriate official. An attestation engagement should be performed only when:

- all relevant ethical requirements, including independence, will be satisfied,
- the engagement team is competent to perform the engagement,
- the engagement meets all the preconditions for an attestation engagement,
- a common understanding with the requestor has been reached in the terms of the engagement, including the auditor's reporting responsibilities.

d. In cases where the attestation engagement may relate to only part of a broader subject matter, the auditor should consider which type of engagement is appropriate to meet the information needs of intended users (i.e., an examination, agreed-upon procedures, or a performance audit).

d. Audit team members to understand their responsibilities, including the objectives of the procedures they are to perform and matters that may affect the nature, timing, and extent of such procedures.

e. In planning an examination engagement, the audit team should obtain an understanding of relevant portions of internal control over compliance in order to sufficiently plan the engagement and assess the level of control risk for compliance with specified requirements. Such knowledge should be used to identify potential noncompliances that could result in material noncompliance, and to design appropriate tests of compliance.

f. In an engagement to examine compliance with specified requirements, the audit team should seek to obtain reasonable assurance that the contractor complied with the specified requirements, in all material respects, including designing the examination to detect both intentional and unintentional material noncompliance.

g. When planning the audit the audit team should consider materiality when establishing the overall engagement strategy.

h. Refer to 2-304 for additional guidance on planning specific to attestation examination engagements and 2-307 for additional guidance specific to agreed-upon procedures engagements.

### **2-303.3 Proper Supervision (AT-C 105.33) [\\*\\*](#)**

a. Auditors must be properly supervised. Individuals supervising engagements and reviewing the work performed must have appropriate levels of skill and proficiency in auditing. Supervision involves directing the efforts of the audit team to accomplish the audit objectives and determining whether the objectives were met. This includes responsibility to ensure:

- The engagement is established with audit objectives to meet the needs of the intended user of the report,
- The engagement is planned and performed to comply with professional standards and applicable legal and regulatory requirements.
- Engagement documentation is reviewed in accordance with Agency policy and approved before the report is issued,
- Appropriate engagement documentation is maintained to provide evidence that the audit objectives were met and sufficient appropriate evidence was obtained to support the significant findings and audit opinion.
- Appropriate consultation is undertaken on difficult or contentious matters.

b. The supervisory auditor and FAO manager will generally perform the following to provide proper supervision:

- Track the progress of the engagement,
- Consider the competence and capabilities of the engagement team, both individually and collectively,
- Ensure resources are sufficient to carry out the work,
- Determine whether the work performed is in accordance with the audit plan,
- Address significant findings and issues that arise during the engagement, consider the significance of the issues, and appropriately address the issues (e.g., modifying the audit plan, identify the need for consultation with specialists, or engaging more experienced team members, etc.).

c. The auditor has primary responsibility to prepare and execute the audit program and draft the audit report. Depending on the auditor's level of competence for the engagement objectives, an auditor may act alone, or may be assisted by other auditors during the assignment. Each individual auditor is responsible for the professional adequacy of his/her own work. When

the audit is conducted by a team, a lead auditor may be responsible for monitoring the day-to-day activities of engagement team and may review their working papers for both format and content.

d. Supervisory responsibilities are outlined in [DCAAI 7642.2](#), Management Review and Technical Support of Audits.

e. The depth and extent of supervision is driven by the nature and complexity of the engagement, the competency and experience of the individual audit team members performing the work, and experience with the contractor.

f. Appropriate supervision occurs before, during, and after completion of the field work. In planning the engagement, the supervisory auditor should discuss the audit objectives to ensure the audit team understands the purpose and scope of the audit, the objectives of the planned procedures, and any special matters that may affect the nature, extent, and timing of such procedures.

g. For examinations, the supervisory auditor should ensure that the engagement has been adequately scoped, and that the audit program has been developed consistent with the purpose and scope of the audit and that steps have been tailored specifically to meet the assignment objectives, and the work performed matches the work planned in the risk assessment.

h. For an agreed-upon procedures engagement the supervisory auditor should ensure that the agreed-upon procedures are appropriate and that the requestor has agreed that the procedures are acceptable for the intended purpose. See [14-1000](#), application of agreed upon procedures.

i. The supervisory auditor should ensure that arrangements have been made for any necessary external support, such as assist audits or specialist assistance.

j. Depending on the complexity of the engagement and experience of the audit team, appropriate FAO management (the supervisory auditor and, in some cases, the FAO manager) may participate in entrance and exit conferences, as well as other significant conferences held with the contractor.

k. Throughout the engagement the supervisory auditor should:

- (1) provide technical guidance on audit or accounting issues,
- (2) review and approve any major changes needed to the audit program
- (3) review and approve changes necessary for budgeted time or revisions of the due date,
- (4) perform interim reviews, as warranted, based on the complexity of the assignment, and document review comments using the CaseWare Issues function), and
- (5) be aware of the status of the engagement,
- (6) consider whether significant findings and issues have been raised for further consideration and that appropriate consultations have taken place and that the resulting conclusions have been documented and implemented.

l. After the conclusion of field work, the supervisory auditor will review the working papers and the report draft for compliance with GAGAS, professional quality, accuracy, and responsiveness to the audit request. The review should be in sufficient depth to determine whether the work was adequately performed and whether the working papers are consistent with

the conclusion in the report. The supervisory review must be completed and documented in the working papers prior to report issuance, and should include verification that:

- (1) the auditors conformed to the auditing standards,
- (2) the engagement was completed as planned and the audit team accomplished the audit objectives, unless a deviation is documented, justified and authorized,
- (3) for examinations, the working papers demonstrate sufficient appropriate evidence was obtained to adequately support findings or conclusions (see 2-306.8 for the GAGAS on documentation), and the report is responsive to the audit objectives,

m. The supervisory auditor will make or recommend any necessary changes to the report draft, and document the review comments (using the CaseWare Issues function) in the working paper file.

n. In addition to providing direction, advice and assistance throughout the audit as needed, the FAO manager should review all audits determined to be sensitive or high risk, and to review the content and format of draft reports where the Supervisory Auditor does not have signature authority. The FAO manager should review key working papers as deemed necessary and, at a minimum, the audit package should include evidence of FAO manager's review of the report in the form of signature or initials and the date reviewed.

o. The FAO manager may be more directly involved in audits of unusual materiality or sensitivity and may participate in individual audit assignments that involve significant issues, such as denial of access to records or timeliness of reporting, and may attend significant conferences with contractors.

p. The FAO manager, or acting FAO manager, shall not delegate signature authority for certain types of reports. See [DCAA Instruction 5600.1](#), Delegation of Signature Authority for Audit Reports and Other Audit Related Documents for delegation and re-delegation authorities.

#### **2-303.4 Obtaining Sufficient Evidence (AT-C 205.19-.31, AT-C 205.A49-.A53) \*\***

The auditor must obtain sufficient appropriate evidence to provide a reasonable basis for the conclusion expressed in the report. The extent to which procedures will be performed should be based on the level of assurance provided. Refer to 2-306.4 for guidance designing substantive audit tests to obtain sufficient evidence for an attestation examination engagement and 2-307.3 for guidance on performing agreed-upon procedures engagements.

#### **2-303.5 Documentation (AT-C 105.34 – 105.41) \*\***

- a. Engagement documentation should be prepared on a timely basis.
- b. If the auditor found it necessary to depart from a relevant, presumptively mandatory requirement, the auditor must document the justification for the departure and how alternative procedures performed in the circumstances were sufficient to achieve the intent of the requirement.

#### **2-303.6 Materiality (AT-C 105.16-105.17, GAGAS 7.05 – 7.06) \*\***

a. Materiality is defined as misstatements, including omissions, individually or in the aggregate, that could reasonably be expected to influence relevant decisions of intended users that are made based on the audited information. Materiality is considered in the context of

qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative and quantitative factors when considering materiality in a particular engagement is a matter for the audit team's professional judgment. See [6-107](#) for additional information related to materiality and how to calculate quantitative materiality thresholds for incurred cost audits.

b. When establishing the overall engagement strategy, the practitioner should consider materiality for the subject matter and reconsider materiality if the auditor becomes aware of information during the engagement that would have caused the auditor to have initially determined a different materiality.

c. Preliminary judgments regarding materiality and sensitivity assist in identifying accounts, cost elements or areas for substantive testing. Establishing preliminary judgments about materiality helps ensure matters that could be material to the subject matter, either individually or in the aggregate, are a primary consideration in performing the audit procedures.

#### **2-304 RESERVED \*\***

#### **2-305 Examination Engagements – Communication (AT-C 205.07-.08 ) \*\***

a. Prior to accepting the engagement, the auditor team should communicate with the requestor or responsible government official, as applicable, to agree on the terms of the engagement. The agreed-upon terms should be in writing, and each standard audit program has a proforma acknowledgement letter or memorandum, depending on the type of service being provided. The written agreed-upon terms should include the following information:

- (1) The objective and scope of the engagement,
- (2) The level of assurance the report will provide. This will generally be the type of engagement/audit service provided; e.g., examination with an opinion,
- (3) The auditor's responsibilities,
- (4) A statement identifying whether the engagement will be conducted in accordance with GAGAS,
- (5) The requestor or responsible government official's responsibilities,
- (6) A statement about the inherent limitations of an examination engagement,
- (7) Identification of the criteria that will be used for the measurement, evaluation, or disclosure of the subject matter,

b. Restrictions in the audit report regarding use of audit report. For example, DCAA audit reports generally include restrictions regarding the release of the report to other parties due to proprietary information, and also warn that the report should not be used for purposes other than those for which the engagement was conducted.

c. Auditors should also communicate the above information to appropriate representatives of the audited entity. This is generally provided through the contractor notification letter and at the entrance conference.

d. Refer to [1-303](#) for guidance on processing requests from Non-DoD Agencies; and [4-102](#), [4-104](#), [4-300](#) and [4-302.3](#) for guidance on communicating with the requestor and contractor.

**2-306 Examination Engagements – Risk Assessment (GAGAS 7.13 – 7.16, AT-C 205.14-.18) \*\***

a. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application. Planning an attestation examination engagement involves developing an overall strategy that sets the scope, timing, and direction of the engagement and guides the development of the audit plan. The audit team needs to have sufficient knowledge to determine the events, transactions, and practices that have a significant effect on the subject matter or assertion.

b. Attestation risk is the risk that the auditor will determine that the subject matter or assertion is fairly stated when it actually contains material misstatements. In general, attestation risk is composed of inherent risk, control risk, and detection risk, although all three of these components may not be present or significant for a given engagement. In order to prepare an appropriately detailed audit program, the audit team must perform a risk assessment to assess the attestation risk relative to the audit objectives.

c. Because an attestation examination provides a high level of assurance on whether the subject matter or assertion is presented in accordance with the criteria in all material respects, or that the assertion is fairly stated, the audit team should establish an appropriately low-level of attestation risk to support the high level of assurance provided.

**Risks the auditor does not directly influence:**

Inherent risk. The susceptibility of the subject matter to a material misstatement before consideration of any related controls.

Control risk. The risk that a material misstatement or noncompliance will not be prevented, or not be detected and corrected on a timely basis by the contractor.

**Risks the auditor can directly influence:**

Detection risk. The risk that the audit procedures will not detect a material misstatement or noncompliance that exists.

d. In order to keep the overall audit risk to an acceptable limit, the auditor must assess the level of risk for each component of audit risk.

e. A properly performed risk assessment should provide information about risk factors relevant to the subject matter of the audit. In planning the attestation examination, the audit team should use the information obtained during the risk assessment to identify types of potential noncompliance and factors that may impact the risk of material noncompliance in order to appropriately design substantive tests (i.e., detailed testing and substantive analytical procedures) to obtain sufficient appropriate evidence to achieve the objectives of the audit and form an opinion.

**2-306.1 Inherent Risk (205.A14, GAGAS 7.17) \*\***

a. Assessing inherent risk involves obtaining an understanding of the criteria, the subject matter of the audit, and the entity and its environment (e.g., complexity of the subject matter or assertion, the length of time the entity has had experience with the subject matter and criteria). It includes considering known risk factors, prior experience with the entity's compliance, potential impact of fraud or noncompliance on the assertion or the subject matter being audited, and

making preliminary judgments about materiality for attest purposes.

b. The audit team should consider whether the contractor takes implements appropriate corrective actions timely to address findings, and consider whether their experience in responding to findings impacts the auditor's assessment of inherent risk.

c. Auditors may use inquiries, analyses, analytical procedures, and team brainstorming discussions to identify inherent risk factors to gain sufficient understanding to identify the areas of material risk associated with the subject matter in order to respond accordingly.

d. When assessing inherent risk the audit team should:

(1) Review contracts, contract briefs, or the request for solicitation or proposal, and correspondence with the requestor, to gain an understanding of the audit criteria, the subject matter, and the contractor's environment.

(2) Communicate with the contracting officer to learn of any known concerns and discuss any significant concerns or other information that the contracting officer may have relevant to the engagement that may impact audit risk.

(3) Make preliminary judgments of assessed inherent risk levels regarding materiality to select accounts, cost elements or audit areas for substantive testing.

(4) Consider whether specialist assistance is needed to evaluate contractor's information system, such as the nature and extent to which information technology is used relative to the subject matter or assertion, the complexity of the information system, types of information technology, etc. Refer to [4-503](#) for information regarding obtaining guidance and assistance from the DCAA Technical Support Branch.

e. The assessment of inherent risk should be documented in the working papers in sufficient detail to enable the members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent of the assessment and the inherent risk factors identified.

#### **2-306.2 Understanding Internal Controls (AT-C 205.15) \*\***

a. Auditors should obtain an understanding of internal control over the preparation of the subject matter relevant to the engagement in order to appropriately plan the examination to achieve the audit objectives. See also [5-100](#) for guidance on obtaining an understanding of a contractor's internal controls and assessing control risk for contractor business systems subject to DFARS 252.242-7006.

This includes evaluating the design of those controls relevant to the subject matter and determining whether they have been implemented, by performing procedures in addition to inquiry of personnel responsible for the subject matter.

b. The auditor's understanding of internal control should include gaining knowledge of the contractor's control environment, information and communication methods, processes for assessing risk, monitoring processes, and control activities relevant to the assertion or the subject matter. Auditors should use professional skepticism and professional judgment when evaluating how the various components of internal control impact the subject matter.

c. The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The board of directors and

senior management establish the tone at the top regarding commitment to integrity, ethical values, and competency, and the importance of internal control including expected standards of conduct. The control environment establishes the organizational structure and assignment of authority and responsibility. A robust control environment sets the expectations for managing the organization in manner that achieves the organization's objectives, and enforces accountability through structures, and assigned authorities and responsibilities.

d. 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, measures the value of transactions in a manner that permits proper assignment and allocation of cost, records transactions in the proper accounting period, and provide consistent and accurate reporting of the information.

e. Control activities are the actions established through policies and procedures that help ensure management's directives to mitigate risks to achieve the organizational objectives is carried out. Control activities are performed at all levels of the entity, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature and encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews.

(1) Control activities relate to the prevention or timely detection of unauthorized transactions and unauthorized access to assets, such as:

- Proper authorization of transactions,
- Segregation of duties that reduce opportunities for an individual to be in a position to both perpetrate and conceal errors or irregularities,
- Adequately safeguarding over access to and use of assets and records, such as secured facilities and access to computer programs and files.

(2) Controls over compliance with laws and regulations provide for:

- Design and use of documents and records to help ensure proper recording of transactions and events.
- Independent checks on business performance and proper valuation of recorded amounts, such as manual clerical checks and comparison of assets with recorded accountability, automated controls, and reviewing computer-generated reports.

(3) The Agency's standard audit programs for business systems (available on the DCAA Intranet and in CaseWare) identify specific control objectives, likely control activities for accomplishing those objectives, and audit procedures for evaluating the contractor's control activities.

f. Auditors may gain an understanding of the design of specific controls through various procedures, including:

- (1) Inquiries of appropriate management, supervisory, and staff personal,
- (2) Inspection of entity's documents,

- (3) Observation of the entity's activities and operations,
- (4) Re-performance of calculations.

Inquiry alone is not sufficient to enable the auditor to gain an understanding of the design of specific controls.

### **2-306.3 Assessing Control Risk (AT-C 105.A10) \*\***

a. Control risk is the risk that a material misstatement or noncompliance that could occur in the subject matter will not be prevented, or detected and corrected, on a timely basis by the contractor's internal control.

b. Assessing control risk below maximum means there are effective controls to prevent or detect misstatements or noncompliances. Therefore, the assessment of control risk below maximum should be based on evidence of operating effectiveness of the controls, where the controls have been tested and found to be effective during the entire period of reliance. If the contractor's internal controls are unlikely to be effective, or because it would be inefficient to evaluate their effectiveness, the auditor may choose not to perform the tests of controls needed to assess control risk below maximum when planning substantive audit tests.

c. Setting control risk at maximum does not relieve the auditor of the responsibility to gain a sufficient understanding of relevant internal controls to appropriately plan the audit. Auditors need to understand the contractor's processes related to the significant inherent risk factors and to design the appropriate audit procedures to address the heightened risk.

d. When the internal controls have been tested and determined to be effective for the entire period of reliance (e.g., the entire fiscal year underlying an incurred cost proposal), the auditor should rely on them and reduce the amount of substantive testing in the applicable audit area.

e. The assessment of control risk should be documented in the audit working papers in sufficient detail to enable the members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent of the assessment and the control risk factors identified relevant to the assertion.

### **2-306.4 Detection Risk and Designing Substantive Audit Tests \*\***

a. The process of assessing control and inherent risk provides evidential matter about the risk that a significant noncompliance or material misstatement may exist in the assertion or the subject matter. Detection risk is risk that the audit procedures to be performed by the auditor will not detect a material misstatement or significant noncompliance.

b. When the auditor's assessment of inherent and control risk is high, detection risk must be established at a low risk level to keep the overall audit risk at an acceptable level to support the high level of assurance being provided by the audit report. A Lower detection risk is generally achieved by increasing the amount of substantive testing. Conversely, where the auditor has assessed the inherent and control risk of the engagement to be low, a higher level of detection risk may be appropriate, resulting in reduced substantive testing. The working papers must clearly document the rationale for the assessments of each risk-type and the overall assessment of audit risk.

c. The audit team should use their understanding of the internal control structure, the

assessed level of control risk and consideration of inherent risk and consideration of materiality to assess detection risk and design substantive procedures for testing the contractor's assertion or the subject matter.

d. Substantive procedures include substantive analytical procedures and tests of details. Sufficient procedures must be performed to obtain sufficient appropriate evidence during tests of the contractor's assertion in relation to the audit criteria to provide a reasonable basis for the high level of assurance expressed in the report.

e. The nature and extent of substantive procedures performed is based on the assessed level of audit risk; however, audit risk will never be low enough to entirely eliminate the need for substantive procedures. Furthermore, inquiry and/or analytical procedures alone are not sufficient to support the high level of assurance provided in an examination engagement. Procedures to obtain evidence can include inspection, observation, confirmation, recalculation, re-performance, and analytical procedures, often in some combination, in addition to inquiry. Tests of details must be performed in all examination engagements. See [3-204.14](#) for additional guidance on the sufficient, appropriate audit evidence and adequate testing.

f. The audit team should document how the planned substantive procedures are adequate to obtain sufficient appropriate audit evidence and are in response to the assessed level of audit risk. This documentation should be in sufficient detail to enable the members of the engagement team with supervision and review responsibilities to understand the link between the risk assessment and the decision of what audit procedures to perform.

g. A written audit program should be prepared for each engagement to effectively communicate the objectives of the engagement to staff members, to facilitate managing the audit work, and to provide a permanent record of the work accomplished. The planned testing of details should be clearly documented in the audit program. The Agency's work packages and standard audit programs are used to meet these objectives, see [3-203](#).

h. When assist audits or the One Agency Approach is used, the FAO that is centrally planning the work should assure that assisting auditors receive appropriate background information, including purpose, scope, level of evaluation (i.e. examination), and relevant documentation to facilitate efficient completion of the field work and reporting.

#### **2-306.5 Waste and Abuse (GAGAS 7.22 – 7.32) \*\***

a. Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste can include activities that do not include abuse and does not necessarily a violation of law. Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

b. Abuse is behavior that is deficient or improper when compared with the behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate.

c. Because the determination of waste and abuse is subjective, auditors are not required to detect waste or abuse in examination engagements. However, auditors may consider whether and how to communicate such matters if become aware of them.

## **2-306.6 Avoiding Interference with Investigations or Legal Proceedings \*\***

a. GAGAS 7.14 requires that auditors inquire of management of the audited entity whether any investigations or legal proceedings significant to the engagement objectives have been initiated or are in process with respect to the period under examination, and evaluate the effect of initiated or in-process investigations or legal proceedings on the current examination engagement. The purpose of the requirement is to identify items that need to be reported to law enforcement or investigatory authorities, and to identify areas where action needs to be taken to avoid interfering with investigations and legal proceedings. This inquiry is separate from inquiries made regarding management's awareness of fraud, which may result in an increase in audit scope and testing.

b. Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements. Laws, regulations or policies may require auditors to report indications of certain types of fraud and noncompliance with provisions of laws, regulations, contracts, or grant agreements to law enforcement or investigatory authorities before performing additional audit procedures.

c. When investigations or legal proceedings are initiated or are in process, auditors should evaluate the impact on the current examination engagement. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, cancel the engagement, or reduce the scope of the engagement to avoid interfering with the investigation or legal proceeding.

d. The information in [4-702.5](#) provides guidance on actions the audit team should consider when a fraud referral, legal proceeding, or investigation affect an engagement. Additionally, [1-405](#) provides guidance for interacting with external investigators (e.g., Federal Bureau of Investigation or DoD criminal investigators).

e. Inquiries made to contractor management to identify other studies or audits that directly relate to the subject matter under audit may assist the auditor in identifying ongoing investigations or legal proceedings that may need to be considered in planning the engagement to avoid interfering with investigations or legal proceedings.

f. See [4-702.6](#) for auditor responsibilities related to supporting investigative activities.

## **2-306.7 Developing the Elements of a Finding (GAGAS 7.19 – 7.32) \*\***

a. When auditors identify findings, sufficient procedures should be planned and performed to enable the auditor to develop the elements of the findings that are relevant and necessary to achieve the examination objectives. The elements of a finding should be developed to assist the contracting officer in understanding the finding and the need for corrective action

b. A finding or set of findings is complete to the extent that the examination objectives are satisfied. The elements of a finding include the criteria, condition, cause, and effect or potential effect. When developing the cause element, auditors should consider internal control deficiencies.

c. Guidance on developing structured notes and the elements of a finding are contained in [10-211.2](#).

**2-306.8 Examination Engagement Documentation (AT-C 205.87-.89, GAGAS 7.33 – 7.38) \*\***

a. Engagement documentation, commonly referred to as working papers, should be sufficient to determine:

(1) the nature, timing, and extent of procedures performed, including:

- identifying characteristics of specific items or matters tested,
- who performed the engagement work and the date the work was completed,
- discussions with the contractor or requestor/ACO, as applicable, about findings or issues that are significant. The documentation should identify when and with whom the discussions took place,
- who reviewed the engagement work performed and the date and extent of such review.

(2) results of the procedures performed and the evidence obtained.

(3) how the auditor addressed information that was inconsistent with the final conclusion,

(4) if there is a change in the engagement objectives, the auditor should document the revised engagement objectives and the reasons for the change.

b. Additionally, GAGAS 7.33 – 7.34 requires documentation of the following:

(1) before the date of the report issuance, documented supervisory review of the evidence that supports the findings, conclusions, and recommendations contained in the examination report,

(2) any departures from GAGAS requirements and the effect on the engagement and on the auditors' conclusions. This is applicable when the auditor did not comply with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the engagement.

(3) for examination engagements to be in sufficient detail to enable an experienced auditor, having no previous connection to the engagement, to understand from the documentation the nature, timing, extent, and results of procedures performed and the evidence obtained, and its source, and the conclusions reached.

(4) evidence that supports the auditors' significant judgments and conclusions.

c. Examination documentation should include evidence supporting all significant findings, conclusions, auditor judgments, and recommendations. This includes explanations for auditor's rationale on all significant findings or issues that require the exercise of professional judgment and related conclusions to include the relevant facts that were known by the auditor at the time the conclusion was reached. Documentation provides the evidence to support the auditors' statement of compliance with GAGAS in the audit report and the auditors' conclusions. The final engagement file should include the engagement objectives, scope of the examination, methodology for assessing risk and performing field work, and the understanding with the requestor/ACO regarding the services to be performed.

d. When the timeliness of an audit report is critically important, it may be acceptable to issue the report before non-critical working papers are complete. Non-critical working papers (generally administrative working papers) are those that do not impact obtaining and evaluating sufficient appropriate evidence supporting significant findings, judgments, conclusions, and recommendations. The auditing standards require all working papers to be completed within 60 days of issuing the report.

e. Revisions to working papers may be necessary after the audit report has been issued. See [4-410](#) for guidance in supplementing engagement working paper files.

f. See [3-200](#) for guidance on developing an engagement assignment. Sufficiency of audit evidence is presented in [3-204.14](#) and [4-400](#). DCAA policies and procedures related to format and content of DCAA working papers is contained in [4-403](#). See [4-407](#) and 2-S103.4 for documenting supervisory reviews in the working papers.

### **2-306.9 Terminating an Examination Engagement (GAGAS 5.25) \*\***

a. If an examination engagement with 8 or more hours incurred on the assignment is terminated before it is completed, the auditor should write a memorandum for record to be maintained in the engagement file. The memorandum for record should describe the work performed up to the date of cancellation and explain the reason for terminating or cancelling the assignment (see [4.403f](#)).

b. When the contractor or contracting officer (or requestor) were notified of the assignment through a formal notification or acknowledgment letter or through informal communication (e.g., verbally or e-mail), the auditor should notify them that the assignment has been terminated or cancelled and include documentation of that communication in the administrative working papers for the assignment.

### **2-307 Agreed-Upon Procedures Engagements (GAGAS 7.78 – 7.85, AT-C 215 (as amended by SSAE 19)) \*\***

Agreed-upon procedures engagements are conducted in accordance with GAGAS 7.78 – 7.85 and AICPA AT-C 105 and AT-C 215 (As amended by SSAE 19). An agreed-upon procedures engagement is an engagement in which the auditor performs specific procedures on subject matter or an assertion and report the findings without providing an opinion or a conclusion. The intended users assess for themselves the procedures and findings reported by the auditor and draw their own conclusions from the work performed by the auditor. This section provides general guidance for conducting an agreed-upon procedures engagement in compliance with GAGAS.

#### **2-307.1 Planning – Agreed Upon Procedures Engagement \*\***

a. Before accepting and engagement to perform agreed-upon procedures (AUP), the auditor should document the terms of the engagement agreed-to with the requestor. The requestor best understands his own needs, and must agree to the procedures to be performed and acknowledge (preferably in writing) that the procedures are appropriate for the intended purpose. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. Auditors should not agree to perform procedures that are subjective or that would require rendering an opinion or providing any level of assurance (see [14-1000](#)).

b. An agreed-upon procedures engagement is one in which a report is issued on specific agreed-upon procedures that are applied to a subject matter or assertion. Because the auditor is precluded from expressing an opinion or conclusion, it is not appropriate to state that the intended purpose of the engagement was to determine whether the subject matter was prepared or is stated in accordance with specified criteria or that the auditor performed the engagement to conclude whether the entity complied specified criteria.

c. The auditor should determine that procedures can be designed, performed, and reported on using an AUP engagement. The procedures applied to the subject matter should be expected to result in reasonably consistent findings.

### **2-307.2 Communication – Agreed Upon Procedures Engagement \*\***

a. Establishing an understanding with the customer about the nature and the terms of the engagement reduce the opportunities for misunderstandings regarding the nature of the engagement and what the customer can expect in the form of reported results. See [14-1002](#) for guidance with establishing an understanding with the requestor.

b. The auditor will communicate with the requestor to establish an understanding regarding the nature of the engagement, including the following:

- The intended purpose of the engagement and the intended users of the AUP report,
- Whether the AUP report is expected to be restricted to the use of specified parties,
- Whether the engagement is performed pursuant to any law, regulation, or contract,
- Whether parties in addition to the requestor will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.

c. The auditor will communicate with the requestor to come to agreement on the terms of the engagement. The agreed-upon terms should include the following:

- (1) The nature of the engagement (discussed in a. above)
- (2) Identification of the subject matter and the contractor responsible for the subject matter or assertion
- (3) The auditor's responsibilities
- (4) A statement that the engagement will be conducted in accordance with GAGAS
- (5) A statement that the contractor is responsible for the subject matter
- (6) A statement that, prior to completion of the engagement, the requestor agrees to provide the auditor with a written agreement and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement
- (7) The expected form and content of the AUP report, including any use restrictions
- (8) Other information as applicable, such as assistance to be provided by the customer, involvement of external specialists, specified thresholds for reporting exceptions.

d. See [4.403f](#) for auditor actions when an agreed-upon procedures is terminated and canceled before it is completed. The auditor should communicate with the contractor and

customer that the engagement has been terminated/cancelled and document that communication in the administrative working papers for the assignment.

e. If the auditor becomes aware of potential or actual instances of fraud or significant waste or abuse during application of the agreed-upon procedures, the auditor should consider the guidance in [4-700](#) to determine any actions that need to be taken in response to the information.

### **2-307.3 Evidential Matter – Agreed-Up Procedures Engagements (AT-C 215) \*\***

a. The auditor should obtain evidence from applying the procedures to provide a reasonable basis for the finding or findings expressed in the audit report. The auditor does not need to perform additional procedures outside the scope of the engagement to gather additional evidence.

b. The auditor has no responsibility to determine the differences between the agreed-upon procedures to be performed and the procedures that the auditor would have determined necessary to perform if the auditor had been engaged to perform another form of attest engagement.

c. Refer to [14-1002.2](#) for examples of appropriate agreed-upon procedures

d. If the auditor becomes aware of significant deficiencies, material weaknesses, instances of fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, waste, or abuse when applying the agreed-upon procedures, the auditor should discuss with the supervisory auditor whether the existence of such matters affects the auditor's ability to apply the procedures or report on the engagement.

e. When circumstances impose restrictions on the performance of the agreed-upon procedures, the auditor should attempt to obtain agreement from the specified parties for a modification of the agree-upon procedures. If the requestor agrees to the modified procedures, the auditor should obtain an updated affirmation from the requestor that the modified procedures are acceptable and issue an updated engagement letter. When the requestor does not agree to the modified procedures (e.g. the procedures are to test an element of cost for compliance with a specific regulatory clause) the auditor should describe any restrictions on the performance of agreed upon procedures in the AUP report or terminate the engagement, as appropriate.

### **2-307.4 Reporting and Statement of Compliance with GAGAS (GAGAS 7.82, AT-C 215.31-.36 (as amended by SSAE 19)) \*\***

a. When auditors comply with all applicable GAGAS requirements for agreed-upon procedures engagements, they should include a statement in the agreed-upon procedures engagement report that they conducted the engagement in accordance with GAGAS.

b. Because agreed-upon procedures engagements are substantially less in scope than audits and examination engagements, it is important not to deviate from the required reporting elements contained in the AICPA attestation standards incorporated by GAGAS, other than to include the reference to GAGAS. AT-C 215 (as amended by SSAE 19) provides requirements for the content of the Agreed-Up Procedures Report. The auditor should review the revised AT-C 215 standard to ensure the AUP report complies with the audit standards.

c. A required element of the report on agreed-upon procedures is a statement that the auditors were not engaged to and did not conduct an examination or a review of the subject matter, the objective of which would be the expression of an opinion or a conclusion, respectively, and that had the auditors performed additional procedures, other matters may have

come to their attention that would have been reported.

d. The auditor may describe the criteria or measurement framework used by the contractor to develop the subject matter may assist the customer in determining whether the procedures are appropriate for their purposes.

e. When the subject matter or assertion are provided directly by the customer, it may appropriate to include the following statement in the audit report: “In performing our agreed-upon procedures engagement, we have relied solely on representations provided by the [identify the requestor/customer] relating to the contractor and its responsibility for [identify the subject matter].

f. If the requestor specifies the procedures to be applied, it may be appropriate to explicitly state that the auditor makes no representation regarding the appropriateness of the procedures either for the purpose for which the report has been requested or for any other purpose.

g. The auditor is not responsible for controlling, and cannot control, distribution of the report after its release. Therefore, the auditor may include a statement in the AUP report to advise users regarding inappropriate uses of the agreed-upon procedures report. For example, that the report is not intended for making investment decisions or for use by potential lenders.

h. When applicable, the report should include any necessary reservations or restrictions concerning the procedures or findings. Examples of reservations or restriction may include such items as: disclosure of stipulated facts, assumptions, or interpretations used in the application of procedures; description of the condition of records, controls, or data to which the procedures were applied; explanation that the auditor has no responsibility to update the report; explanation that the sample (subject matter) may not be representative of the population. Reservations or restrictions may require the auditor to use a modified statement of GAGAS compliance depending on the significance of the reservation or restriction.

i. If, during the course of applying the agreed-upon procedures, the auditor becomes aware of a material weakness in internal control or other significant noncompliance by means other than applying the procedures, such matter may be included in the AUP report if deemed necessary.

## **2-400 Section 4 – Attestation Examinations – Reporting ((GAGAS 7.19 – 7.69, AT-C 105, AT-C 205, AT-C 315) \*\***

### **2-401 Introduction \*\***

The Generally Accepted Government Auditing Standards (GAGAS) and AICPA SSAE 18 (AT-C 105, 205 and 315) contain standards for reporting for attestation examinations. This section discusses the requirements for reporting in examination engagements. See 2-307.4 for reporting requirements for agreed upon procedures.

### **2-402 Reporting Requirements for Attestation Examination Engagements \*\***

For examination engagements the audit team’s opinion, conclusion, or findings, are provided through a written audit report that is appropriate for the engagement objectives.

### **2-402.1 Subject and Character of Engagement \*\***

- a. The audit report must identify the subject matter or the assertion being reported on, the type of engagement performed, and the nature and scope of work performed and in the engagement.
- b. If reporting on the assertion, the assertion should accompany the report or should be clearly stated in the report.
- c. The report must include an appropriate statement on the auditor's compliance with GAGAS.
- d. When performing an examination engagement, the term "examination" should be used to describe the engagement to provide a high level of assurance.
- e. See [10-202](#) for general information on Agency policy to ensure compliance with the standards for reporting. See [10-208](#) for details on report content.

### **2-402.2 Conclusion \*\***

- a. In an examination engagement the auditor must state the auditor's conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated in the report. See [10-208.5](#) for guidance on the different types of audit opinions.
- b. See 2-307.4 and [14-1003](#) for details relating to agreed-upon procedures engagement reports.

### **2-402.3 Significant Reservations and Scope Limitations \*\***

- a. The audit report must state all significant reservations about the engagement, the subject matter or assertion. "Reservations about the engagement" and "reservations about the subject matter" describe the nature of matter. See [10-208.5](#) for guidance on the different types of audit opinions.
- b. A significant reservation about the engagement results in either a qualified opinion or disclaimer of opinion depending on the materiality and pervasiveness of the reservation. A qualified opinion requires the use of a modified GAGAS compliance statement (see 2-105). Reservations about the engagement are scope limitations that occur causing the auditor to be unable to obtain sufficient appropriate evidence, and can include unresolved problems the auditor had in complying with applicable GAGAS requirements, such as not performing all procedures considered necessary in the circumstances.
- c. A significant reservation about the subject matter results in either a qualified or adverse opinion depending on the materiality and pervasiveness of the departure from the criteria. A reservation about the subject matter does not require a modified GAGAS compliance statement unless there is also in a significant reservation about the engagement (for example, a contractor's denial of access to records may result in both reservations about the engagement and reservations about the subject matter). Professional judgment is required to determine whether a particular reservation affects the report given the circumstances and facts the auditor is aware of at the time. Reservations about the subject matter or the assertion occur when the subject matter is materially misstated in relation to conformity of the subject matter with the criteria, and may relate to things such as the measurement, form, arrangement, content or underlying judgments and assumptions applicable to the subject matter or the assertion and its appended notes,

including for example, the terminology used, the amount of detail given, the classification of items, and the bases of amounts.

#### **2-402.4 Restrictions on Use of Report \*\***

a. The need to include restrictions on the use of a 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.

b. See [10-210](#) for guidance on restrictions included in DCAA reports.

c. The report shells delivered with standard audit programs include proforma report restrictions documenting the limitations on report distribution due to sensitive nature of contractor proprietary information. The audit team should tailor the proforma statements as necessary to fit the specific facts and circumstances of the engagement, in accordance with the guidance in [10-210.2](#).

#### **2-403 Additional GAGAS Reporting Requirements for Attestation Examination Engagements (GAGAS 7.39 – 7.54) \*\***

In addition to the reporting requirements contained in the SSAE 18, GAGAS contains requirements for:

(1) reporting the auditor’s compliance with GAGAS

(2) reporting deficiencies in internal control, even when communicated early, that are considered to be significant deficiencies or material weaknesses that the auditor identified based on the engagement work performed.

(3) reporting noncompliance with provisions of laws, regulations, contracts, and grant agreements, or instances of fraud

(4) obtaining and reporting the views of responsible officials

(5) reporting confidential or sensitive information

(6) distributing reports

#### **2-403.1 Reporting Auditors Compliance with GAGAS (GAGAS 7.39-7.41) \*\***

When auditors comply with all applicable GAGAS requirements for an attestation examination engagement the report should include a statement of auditor compliance with GAGAS. See 2-105 for guidance on the use of modified and unmodified GAGAS compliance statements.

#### **2-403.2 Reporting Confidential or Sensitive Information (GAGAS 7.61 – 7.68) \*\***

a. If certain pertinent information is excluded from a report due to the confidential or sensitive nature of the information, the audit report should disclose that certain information has been omitted and the reason or other circumstances that make the omission necessary.

b. Certain information may be classified or otherwise prohibited from disclosure by federal, state, local laws or regulations. In such circumstances, auditors may issue a separate classified or limited use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. When omitting information from the audit

report, the report may reference the information in general, rather than in specific terms, when the information is necessary to prevent the reader from drawing inappropriate conclusions.

c. DCAA attestation examination reports generally include sensitive and confidential information that is subject to regulatory or statutory restrictions. With the exception of Uniform Guidance audit reports performed under activity code 10110 (see [Chapter 13](#)), DCAA reports are not distributed publicly and are restricted from release (see [10-210](#)).

d. [DoD Instruction 7600.02](#); Audit Policies, Enclosure 3, Item No. 3, requires DCAA to refer indications of potential fraud or other criminal acts to the appropriate investigative organization. Therefore, DCAA reports suspected fraud or irregularities separately (see [4-700](#)).

### **2-403.3 Distributing Attestation Examination Reports [\\*\\*](#)**

a. DCAA distributes the audit reports only to persons whose official duties require access to the report in accordance with Department of Defense (DoD) Manual 5200.01, Volume 4-DoD Information Security Program, February 2012, Enclosure 3, paragraph 2.d. The contracting officer provides the report to the contractor at their discretion.

b. General information on audit report distribution is located in [10-210.1](#).

c. See [Chapter 13](#) for guidance on report distribution for Uniform Guidance audits performed in accordance with 2 CFR 200.

d. See [15-100](#) for general guidance on distributing reports to non-DoD agencies, and table [15-1S6](#) provides additional report distribution requirements specified by non-DoD organizations.

### **2-403.4 Reporting Deficiencies in Internal Controls, Noncompliance with Provisions of Laws, Regulations, Contracts, Grant Agreements and Instances of Fraud (GAGAS 7.42 – 7.47, AT-C 205.A30) [\\*\\*](#)**

a. Auditors should include in the examination report all significant deficiencies and material weaknesses in internal control based on the engagement work performed, including those deficiencies that were communicated early. Determining whether and how to communicate internal control deficiencies that are not considered significant deficiencies or material weaknesses to officials of the audited entity is a matter of professional judgment. See 2-306.2 for discussion of understanding internal controls.

b. The examination report should include the relevant information about noncompliance and fraud when auditors, based on sufficient appropriate evidence, identify or suspect:

(1) noncompliance with provisions of laws, regulations, contracts or grant agreements that have a material effect on the subject matter or the assertion about the subject matter that warrant the attention of those charged with governance, and

(2) fraud that is material, either quantitatively or qualitatively, to the subject matter or an assertion about the subject matter that is significant to the engagement objectives.

c. When auditors suspect or identify noncompliance or instances of fraud that are less than material but warrant the attention of those charged with governance, the auditor should communicate in writing to the audited entity officials. It may be appropriate to describe the matter in a separate paragraph in the report. The auditors' determination of whether and how to communicate such instances to government officials is a matter of professional judgment.

d. When considering the materiality of instances of fraud, and noncompliance with provisions of laws, regulations, contracts and grant agreements, auditors should use materiality levels that consider the government's risk and public accountability of the entities receiving government funding, legal and regulatory requirements, and the visibility and sensitivity of government programs.

#### **2-403.5 Reporting Views of Responsible Officials (GAGAS 7.55 – 7.60) \*\***

a. Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations, as well as planned corrective actions. Whenever possible, the comments should be obtained in writing. See [4-304.1e](#) for guidance on when the auditor may provide a draft report with findings to the contractor to facilitate obtaining their views and comments.

b. When auditors receive written comments from the responsible officials, they should include a copy of the officials' written comments or a summary of the comments received. When the contractor provides oral comments, the auditor should include a summary of those comments in the report.

c. The auditor should objectively evaluate the contractor's comments. When the comments disagree with the auditor's findings, conclusions, or recommendations in the report, the auditor should evaluate the validity of the entity's comments. If the auditor disagrees with the comments, an explanation of the reasons for the disagreement should be included in the report. If the auditor finds the comments to be valid and supported by sufficient appropriate evidence, the report should be modified appropriately.

d. If the audited entity declines, or is unable, to provide comments within a reasonable period of time, the auditors should issue the report without receiving comments and indicate in the report that the audited entity did not provide comments.

e. When the audited entity's comments are inconsistent or in conflict with the findings, conclusions or recommendations in the draft report, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors' should evaluate the validity of the audited entities comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find the comments valid and supported by sufficient appropriate evidence.

f. If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from the audited entity. In such cases the auditor should indicate in the report that the audited entity did not provide comments.

g. See [10-208.5d](#) for instruction on where to include the contractor's comments in the audit report.

#### **2-403.6 Reporting Deficiencies in Internal Control (GAGAS 7.42, AT-C 315) \*\***

a. Auditors should include in the examination report all internal control deficiencies, even those communicated early, that are considered to be significant deficiencies or material weaknesses that the auditor identified based on the engagement work performed. Professional judgment is required to determine whether a deficiency, or combination of deficiencies, is a material weakness, a significant deficiency, or less than a significant deficiency. The auditor

should consider deficiencies individually as well as in the aggregate in determining which level of deficiency is present.

b. An entity's internal control over compliance is the process by which management obtains reasonable assurance of compliance with specified requirements. A material weakness in internal control is more severe than a significant deficiency.

c. GAGAS's use of internal control terminology is consistent with the AICPA Statements of Auditing Standards (SAS) No. 122, [AU-C section 265](#), Communicating Internal Control Related Matters Identified in an Audit. [DFARS 252.242-7005\(b\)\(6\)](#) defines a significant deficiency as "A shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes."

d. In evaluating internal control over compliance, the auditor needs to consider both the design and operation of the control. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements or noncompliances on a timely basis. A deficiency in *design* exists when either a control that is necessary to meet the control objective is missing, or an existing control is not designed to meet the control objective. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the authority or competence to perform the control effectively.

e. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement or noncompliance will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable. A reasonable possibility is the chance of a future event occurring is more than remote but less than likely. A probable possibility is that the event is likely to occur.

f. A significant deficiency, or combination of deficiencies, in internal control is less severe than a material weakness yet important enough to merit the attention by those charged with governance. Determining whether and how to communicate to officials of the audited entity those internal control deficiencies that are not consider significant deficiencies or material weaknesses is a matter of professional judgment. When the engagement is a business system audit, deficiencies that are less severe than a significant deficiency should be included in the audit report an appendix titled "Deficiencies that Warrant Attention of the Contracting Officer".

g. Early Communication of Internal Control Deficiencies. For some matters, early communication of deficiencies may be important because of their relative significance and urgency for corrective action. Early communication is important to allow management to take prompt corrective action to prevent further occurrences when a control deficiency results in identified or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements, or identified or suspected fraud. The audit report should include all significant deficiencies and material weaknesses identified based on the engagement work performed even when those deficiencies were communicated early.

#### **2-404 Presenting Findings in the Examination Report (GAGAS 7.48 – 7.50) [\\*\\*](#)**

a. When presenting findings, auditors should develop the elements of the findings to the

extent necessary to assist management or oversight officials of the audited entity in understanding the need for taking corrective action. Clearly developed findings assist oversight officials of the audited entity, such as the CFAO, in understanding the need for corrective action, and assist the auditor in developing recommendations to the CFAO for necessary corrective action.

b. Auditors should place their findings in perspective by describing the nature and extent of issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of the findings, auditors' should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.

c. DCAA presents findings for examination engagements through structured notes, using either explanatory notes or a statement of conditions and recommendations (SOCAR). See [10.211.2](#) for guidance in developing and presenting structured notes for DCAA examination reports.

d. Audit reports should provide relevant information in a manner that facilitates the readers ability to understand and use the information. See [10-104](#) for guidance in developing an effective audit report.

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

### **2-501 Introduction (2018 GAGAS 8.01 – 8.02) \*\***

In the contract audit environment, performance audits are more commonly described as operations audits. DCAA performance audits seek to determine if the contractor is operating in an economical and efficient manner. Economy and efficiency relate to the reasonableness of costs charged to Government contracts, and may also impacts areas such as program schedules operations, etc. Inefficient operations can result in schedule slippages and contract overruns. Examples of subject matter covered by operations audits performed by DCAA include; labor and facilities utilization, and materials inventory management. The 2018 Yellow Book establishes the field work and reporting standards for performance audits in Chapters 8 and 9 respectively. These standards apply to the operations audits performed by DCAA. The auditor must also follow the requirements in 2018 GAGAS Chapters 1 through 5. Fieldwork requirements establish an overall approach for planning and performing the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for findings and conclusions based on the audit objectives.

#### **2-501.1 Reasonable Assurance (2018 GAGAS 8.12-8.13) \*\***

Performance audits that comply with 2018 GAGAS provide reasonable assurance that evidence is sufficient and appropriate to support findings and conclusions in relation to the audit objectives. The sufficiency and appropriateness of evidence needed and tests of evidence will vary based on the audit objectives significance of the, findings, and overall conclusions. Audit objectives for operations audits range from narrow to broad and involve varying types and quality of evidence. In some audits, sufficient, appropriate evidence is available, but in others, information may have limitations. Professional judgment assists auditors in determining the audit scope and methodology needed to address the audit objectives, and in evaluating whether

sufficient appropriate evidence has been obtained to address the audit objectives.

### **2-501.2 Significance in a Performance (Operations) Audit (2018 GAGAS 8.15) \*\***

The concept of significance assists auditors throughout an operations audit, including deciding the type and extent of audit procedures to perform, evaluating results of audit work, and developing the report and related findings and conclusions. Significance is defined as the relative importance of a matter within the context in which it is being considered, and includes both quantitative and qualitative factors, such as: the magnitude of the matter in relation to the subject matter of the audit; the nature and effect of the matter; the relevance of the matter; the needs and interests of an objective third party with knowledge of the relevant information; and the impact of the matter to the audited program or activity. Professional judgment assists auditors when evaluating the significance of matters within the context of the audit objectives.

### **2-501.3 Audit Objectives (2018 GAGAS 6.08) \*\***

a. The audit objectives are what the audit is intended to accomplish. The audit objectives identify the audit subject matter and performance aspects to be performed in the audit. Audit objectives can be thought of as questions about the subject matter that the auditor seeks to answer based on the evidence obtained and assessed against suitable criteria. Information addressing the audit objectives should be provided in an objective, understandable manner.

b. Performance audit objectives vary widely, as discussed in the 2-501 Introduction. The audit team should use professional judgment and consider the requestor's needs and objectives when establishing the audit objectives.

### **2-501.4 Audit Risk (2018 GAGAS 8.16) \*\***

a. Audit risk is the possibility that the findings, conclusions, recommendations, or assurance may be improper or incomplete. It is the risk that auditors will not detect a mistake, inconsistency, significant error, or fraud in the evidence supporting the audit. This risk can be based on factors such as evidence that is not sufficient and/or appropriate, an inadequate audit processes, or intentional omissions of information or misleading information due to misrepresentation or fraud. The assessment of audit risk involves both qualitative and quantitative considerations. Factors of audit risk can include such things as: the complexity or sensitivity of the work; size of the program; operations in terms of dollar amounts; adequacy of the audited entity's systems; the audited entity's processes to detect inconsistencies, significant errors or fraud, and access to records. Audit risk can be reduced by taking actions such as increasing the scope of work, adding specialists, additional reviewers and other resources to the audit team; changing the methodology to obtain additional evidence, obtaining higher quality evidence, or alternative forms of corroborating evidence; and aligning the findings and conclusions to reflect the evidence obtained.

b. The audit planning steps in the performance audit standard audit programs address assessing audit risk.

### **2-502 Planning (2018 GAGAS 8.03 – 8.35) \*\***

a. Audit teams must adequately plan the audit and document the planning of the work necessary to address the audit objectives. Auditors must plan the audit to reduce audit risk to an acceptably low level to provide reasonable assurance that the evidence is sufficient and appropriate to support findings and conclusions. This determination is a matter of professional

judgment. In planning the audit, auditors should assess significance and audit risk and apply these assessments in defining the audit objectives, scope, and methodology. Planning is a continuous process throughout the audit. Therefore, auditors may need to adjust the audit objectives, scope, and methodology as work is being completed.

b. The scope is the boundary of the audit and is directly tied to the audit objectives. The scope defines the subject matter that the auditors will assess and report on, such as the documents or records to be evaluated, the time period of the evaluation and the geographic locations included in the evaluation.

c. The methodology describes the nature and extent of audit procedures for gathering and analyzing evidence to address the audit objectives. Audit procedures are the specific steps and tests auditors perform to accomplish the audit. Auditors should design the methodology to provide reasonable assurance that the evidence obtained is sufficient and appropriate to support the auditors' findings and conclusions in relation to the audit objectives and to reduce audit risk to an acceptably low level.

d. Adequate planning for performance audits includes gaining an understanding of the following, within the context of the audit objectives:

(1) the nature and profile of the programs and the needs of potential users of the audit report. The term program as used in 2018 GAGAS includes processes, projects, studies, policies, operations, activities, entities, and functions.

(2) internal control as it relates to the specific objectives and scope of the audit,

(3) information systems controls for purposes of assessing audit risk and planning the audit,

(4) provisions of laws, regulations, contracts, and grant agreements and potential fraud that are significant to the audit objectives,

(5) ongoing investigations or legal proceedings, and

(6) the results of previous audits and attestation engagements that directly relate to the current audit objectives.

e. The audit team will perform the following activities during the planning phase:

(1) Identify suitable criteria based on the audit objectives that will enable the auditor to evaluate the subject matter,

(2) identify sources of audit evidence and determine the amount and type of audit evidence needed, given the audit risk and significance,

(3) evaluate whether to use the work of other auditors and specialist to address some of the audit objectives,

(4) assign staff and specialists that collectively possess the professional competence necessary to perform the audit, and identify other resources needed to perform the audit,

(5) communicate about planning and performance of the audit to management officials, Those charged with governance, and others as applicable, and

(6) prepare a written audit plan (see 2-502.12).

f. Auditors should communicate an overview of the objectives, scope, methodology, timing of the audit, and planned reporting (including any potential restrictions on the report) to contractor management, including those with sufficient authority and responsibility to implement corrective action in the program or activity being audited and the requestor of the audit services.

**2-502.1 Nature and Profile of the Program and User Needs (2018 GAGAS 8.36 – 8.38) \*\***

a. DCAA auditors perform economy and efficiency audits with primary objectives related to determining the reasonableness of the costs being charged to Government contracts (versus reviewing specific programs). Program audits are typically performed by oversight agencies, such as the DoD OIG and the GAO.

b. 2018 GAGAS 8.36 requires auditors to obtain an understanding of the program under audit and the potential use that will be made of the audit results. Obtaining this understanding helps auditors to assess the relevant risks associated with the program and the impact of those risks on the audit objectives to design the scope and methodology for performing the audit. The auditors' understanding may come from previous knowledge about the program, knowledge gained from inquiries, observations, and reviewing documents while planning the audit. The extent and breadth of those inquiries and observations will vary among audits based on the audit objectives, as will the need to understand the individual aspects of the program. The auditor should consider the nature and profile of a program, which include:

- (1) visibility, sensitivity, and relevant risks associated with the program,
- (2) age of the program or changes in its condition,
- (3) size of the program in terms of total dollars or other measures,
- (4) level and extent of review or other forms of independent oversight,
- (5) the program's strategic plan and objectives, and
- (6) external factors or conditions that could directly affect the program.

c. See 2-504 for additional information on obtaining sufficient and appropriate audit evidence and 2-S103.4, 14-502 and 14-503 for additional information on audit planning and planning considerations.

**2-502.2 Internal Controls (2018 GAGAS 8.41 – 8.67) \*\***

a. Auditors should obtain an understanding of internal controls that are significant to the audit objectives (for example, 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). Consideration of internal control in a performance audit begins with determining the significance of internal control to the audit objectives and documenting that determination. See 2018 GAGAS 8.41 for factors that may be considered when determining the significance of internal control to the audit objectives. Additionally, 2018 GAGAS 8.41 through 8.67 Internal Control provides application guidance related to obtaining an understanding, assessing significance, and reporting deficiencies in internal control as well as considerations related to information systems.

b. GAGAS requires auditors to assess, and document their assessment, of the design, implementation, and/or operating effectiveness of internal control to the extent necessary to

address the audit objectives (2018 GAGAS 8.49). The levels of internal control assessment that may be performed for controls that are significant to the audit objects are:

- (1) assessing the design of controls,
- (2) assessing the design and implementation of controls, or
- (3) assessing the design, implementation, and operating effectiveness of controls.

Assessment of internal control involves designing and performing procedures to obtain sufficient, appropriate evidence to support and document the findings and conclusions on design, implementation, and/or operating effectiveness of controls that are significant to the audit objectives. Key controls are generally assessed during the planning phase, which may include controls at both the entity and transaction levels. Changes may be made to the initial determination of key controls based on information gathered during fieldwork.

c. Assessment of the design and implementation of internal control is crucial to determine if the internal control is operating effectively to meet the control objective:

- **Design.** The design of internal control is assessed by determining whether controls individually and in combination are capable of achieving the objective for the control and addressing the related risk.
- **Implementation.** The implementation of internal control is assessed by determining if the control exists and has been placed into operation. A control that is not effectively designed cannot be effectively implemented.
- **Operating Effectiveness.** The operating effectiveness of internal control is assessed by determining whether controls were applied at relevant times during the period under evaluation, the consistency with which they were applied, and by whom or by what means they were applied. If a control is not effectively designed and implemented, it cannot operate effectively.

d. Auditors should document their assessment of internal control and plan to obtain sufficient, appropriate evidence to support their assessment about the effectiveness of those controls. The effectiveness of significant internal controls is frequently dependent on the effectiveness of the information systems internal controls. Thus, when obtaining an understanding of internal control significant to the audit objectives, auditors should also determine whether it is necessary to evaluate information systems controls.

e. The effectiveness of internal control that is significant within the context of the audit objectives can affect audit risk. Consequently auditors may need to modify the nature, timing or extent of audit procedures based on the assessment of internal controls and the results of internal control testing.

f. Auditors may obtain an understanding of internal control through inquiries, observations, inspection of documents and records, review of other audit reports and/or through substantive tests. The nature and extent of procedures performed to obtain an understanding of internal control will vary depending on specific audit's objectives, audit risk, known or potential internal control deficiencies, and the auditors' knowledge of internal control gained in prior audits.

g. Consider the following principal types of internal control objectives to identify

controls that are significant to the audit objectives.

(1) Effectiveness and efficiency of operations: Controls over operations include policies and procedures that the audited entity has designed and implemented to provide reasonable assurance that the operation meets its objectives, while considering cost-effectiveness and efficiency. Understanding these controls can help auditors understand the program operations.

(2) Relevance and reliability of information: Controls over the relevance and reliability of information include policies, procedures, and practices that have been implemented to provide reasonable assurance that operational and financial information used for decision making and internal and external reporting is relevant and reliable and fairly represented in reports. Understanding these controls can help auditors assess the risk that the information gathered by the entity may not be relevant or reliable, in order to design appropriate tests of the information significant to the audit objectives.

(3) Compliance with applicable laws, regulations, and provisions of contracts or grant agreements: Controls over compliance include policies and procedures that have been implemented to provide reasonable assurance that the program is performed in accordance with applicable laws, regulations, and provisions of contracts or grant agreements. Understanding the relevant controls over compliance with those laws, regulations, and provisions of contracts or grant agreements assist the auditors in identifying the controls that are significant within the context of the audit objectives can assessing the risk of noncompliance with the provisions of contracts or grant agreements, violations of law and regulations, fraud, and illegal acts.

### **2-502.3 Internal Control Deficiencies Considerations (2018 GAGAS 8.54 -8.57) \*\***

a. Deficiencies in internal control may be identified during assessment of a control. A deficiency exists when the design, implementation, or operation of a control does not achieve the desired control objectives to address related risks.

- A design deficiency exists when a necessary control is either missing or not properly designed. An improperly designed control would result in the control objective not being met even if the control operates as designed.
- An implementation deficiency exists when a properly designed control is not correctly implemented.
- A deficiency in operating effectiveness exists when a properly designed and implemented control does not operate as designed, or the person performing the control does not have the necessary competence or authority to perform the control effectively.

b. 2018 GAGAS 8.54 requires auditors to evaluate and document the significance of identified internal control deficiencies within the context of the audit objectives. Deficiencies are evaluated on both an individual and aggregate basis, with consideration given to the correlation among deficiencies.

c. Determining whether deficiencies are significant within the context of the audit objectives involves evaluating the following factors:

- (1) Magnitude of impact, which is the likely effect that the deficiency could have on

the entity (or program) achieving its objectives. Magnitude is affected by factors such as the size, pervasiveness, and duration of the deficiency's impact. A deficiency may be more significant to one audit objective than another.

(2) Likelihood of occurrence

(3) Nature of the deficiency involves factors such as the degree of subjectivity involved with the deficiency and whether the deficiency arises from error, fraud or misconduct.

d. When determining the cause of internal control deficiencies, it may be helpful for auditors to perform an analysis to identify the root cause of the deficiencies, for example, is the deficiency due to improper design or improper implementation, override of the control by staff, etc. This may strengthen the quality of the audit recommendations for corrective actions. Findings of internal control deficiencies should be developed using the four elements of a finding identified in 2018 GAGAS 8.116. See 2018 GAGAS 8.58 for examples of control deficiencies.

#### **2-502.4 Information Systems Controls (2018 GAGAS 8.59 – 8.67) \*\***

a. The effectiveness of significant internal controls frequently depends on the effectiveness of information systems controls. When an auditor obtains an understanding of significant internal controls, the auditor should also determine if it is necessary to evaluate the information systems controls. Understanding information systems controls (e.g., general controls, application controls, user controls) is important when information systems are used extensively throughout the program under audit and the fundamental business processes related to the audit objectives rely on information systems.

b. An organization's use of information systems controls may be extensive; and the auditor should focus on the information systems controls that are significant to the audit objectives. Auditors should evaluate the design, implementation, and/or operating effectiveness of such systems controls. Information systems controls that are significant to the audit objectives may need to be evaluated for effectiveness in order to obtain sufficient, appropriate evidence. Auditors should obtain a sufficient understanding of information systems controls necessary to assess audit risk and plan the audit. See 2018 GAGAS 8.67 for factors that may assist in determining the significance of information system controls to the audit objectives.

c. The evaluation of information systems controls may be done in conjunction with the auditors' consideration of internal control within the context of the audit objectives, or as separate audit objectives or procedures. The extent of the audit procedures to obtain such an understanding depends on the significance of the information system controls to the audit objectives. In addition, the nature and extent of audit risk related to information systems controls area affected by the nature of the hardware and software used the configuration of the entity's systems and networks, and the entity's information systems strategy.

d. Auditors should determine which audit procedures related to information systems controls are needed to obtain sufficient, appropriate evidence to support the audit findings and conclusions. The following factors may assist auditors in making this determination.

(1) Understanding the significance of the impact of the system relative to the accessibility and reliability of the information produced, and

(2) Identifying key controls that are critical to providing assurance that the information required for the audit is reliable and evaluating those key controls, e.g. general, application, and

user controls.

e. The following factors may assist in designing appropriate audit procedures to evaluate the effectiveness of significant information systems controls include:

(1) The extent of assessment of internal controls that are significant to the audit objectives depends on the reliability of the information processed or generated by the information systems.

(2) The availability of evidence outside the information system to support or corroborate findings and conclusions.

(3) The relationship of information systems controls to data reliability: When critical systems controls are effective, the auditor may be able to reduce the extent of substantive testing of the related data.

(4) Evaluating the effectiveness of systems controls as an audit objective: Auditors should test information systems controls necessary to address the audit objectives. For example, the audit objective may involve assessing the effectiveness of systems controls related to certain systems, facilities, functions, or organizations.

**2-502.5 Provisions of Laws, Regulations, Contracts and Grant Agreements (2018 GAGAS 8.68 – 8.70) \*\***

a. Auditors should identify any provisions of laws, regulations, contracts, or grant agreements that are significant to the audit objectives and assess the risk that noncompliance could occur. Based on that risk assessment, the auditor should design and perform procedures to obtain reasonable assurance of detecting instances of significant noncompliance with provisions of laws, regulations, contracts, or grant agreements.

b. The assessment of audit risk may be affected by such factors as the complexity of the laws and regulations and provisions of contracts. The assessment of audit risk may also be affected by whether the entity has controls that are effective in preventing or detecting violations of laws, regulations, and provisions of contracts. If auditors obtain sufficient, appropriate evidence of the effectiveness of these controls, they may be able to reduce the extent of their tests of compliance.

c. Because the determination of waste and abuse is subjective, auditors are not required to perform specific procedures to detect waste or abuse in performance audits. However, auditors may consider whether and how to communicate such matters if they become aware of them. Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements. If, during the course of the audit, auditors become aware of waste or abuse that could be quantitatively or qualitatively significant to the program under audit, auditors should apply audit procedures specifically designed to test if the waste or abuse has a potentially material effect on the subject matter. After performing additional work, auditors may discover that the waste or abuse is indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements (see 4-800).

d. Abuse is behavior that is deficient or improper when compared with behavior that a prudent person would consider a reasonable and necessary business practice given the facts and circumstances. The misuse of authority or position for personal gain or for the benefit of family

members or business associates is also abuse. While abuse is distinct from acts of fraud, or violations of laws and regulations, and provisions of contracts, it may indicate that fraud or noncompliance with laws, regulations, and contracts is occurring. Examples of abuse include management having staff perform personal errands for them, or charging unneeded overtime.

e. Waste is the act of using or expending resources carelessly, extravagantly, or for no purpose. Waste can include activities that do not include abuse, and may not result in violations of law. Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight. Examples of potential waste include making travel arrangements contrary to established policies or that are unnecessarily expensive, or procuring items through vendors that are that are unnecessarily expensive.

#### **2-502.6 Fraud (2018 GAGAS 8.71 – 8.76) \*\***

a. In planning the audit, auditors should assess risks of fraud occurring that are significant to the audit objectives. Fraud involves obtaining something of value through willful misrepresentation. Whether an act is in fact fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility. See [4-700](#) for auditor responsibilities related to suspected or identified instances of fraud.

b. The audit team should discuss the contractor's risk of fraud, including factors such as financial incentives, pressures to commit fraud, opportunities for fraud to occur, and rationalizations or attitudes that could allow individuals to commit fraud. Auditors should gather and assess information to identify risks of fraud that are significant to the audit objectives or that could affect the findings and conclusions.

c. Assessing the risk of fraud is an ongoing process throughout the audit. Professional skepticism assists auditors in assessing which factors or risks could significantly affect the audit objectives. If indications of fraud risk, significant to the audit objectives, arise during the course of the audit that were not identified in the planning stage, the auditor should modify the audit program as necessary and perform procedures designed to detect instances of fraud that are material to the subject matter. For example, auditors may obtain information through discussion with officials of the audited entity or through other means to determine the susceptibility of the program to fraud, the extent to which the audited entity has implemented leading practices to manage fraud risks, the status of internal controls the entity has established to detect and prevent fraud, or the risk that individuals in the audited entity could override internal controls. If the auditors become aware that fraud has, or likely has, occurred, follow the procedures in [4-702.4](#).

d. There is no requirement for auditors to prove the existence of fraud. If the auditors obtain information raising reasonable suspicion of fraud, the procedures in 4-702.3k should be followed to respond to the presence of fraud risk indicators.

#### **2-502.7 Ongoing Investigations and Legal Proceeding (2018 GAGAS 8.27 – 8.29) \*\***

a. Avoiding interference with investigations or legal proceedings is important when pursuing indications of fraud or noncompliance, with provisions of laws, regulations, contracts, or grant agreements. When investigations or legal proceedings are initiated or in process, auditors should evaluate the impact on the current audit. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, or withdraw from or defer further work on the audit or a portion of the audit to avoid interfering with an ongoing investigation or legal proceedings.

b. In relation to reporting fraud, [DoD Instruction 7600.02](#); *Audit Policies*, Enclosure 3, Item No. 3, requires DCAA to refer indications of potential fraud or other criminal acts to the appropriate investigative organization. Procedures for reporting on potential fraud are provided in [4-702.4](#). Procedures on evaluating whether or how to perform audit activities subsequent to referral to avoid compromising the investigation are discussed in [4-702.5](#). Investigative support to investigators or legal authorities is performed by the DCAA Operations Investigative Support (OIS) Division ([4-702.6](#)).

c. See [1-405](#) for guidance on FAO auditor interactions with investigators, the types of information that should be given to the investigator, and how to inform DCAA headquarters of requests made by investigatory agencies for contractor data.

d. In addition to the CAM references above, the audit programs for performance audit have audit planning steps to assist the auditor in avoiding interference with any on-going investigations or legal proceedings.

(1) The auditor should inquire of management during the entrance conference, or other appropriate meetings, regarding management's knowledge of any on-going investigations or legal proceedings or awareness, as well as their knowledge or awareness of any fraud or suspected fraud affecting the subject of the audit. This includes management's awareness of allegations of fraud or suspected fraud affecting the audit objectives, and contractor management understanding about the risks of fraud relevant to the audit objectives.

(2) The audit team (at a minimum, supervisor and auditor) must hold a planning meeting to understand the criteria, subject matter, and the contractor and its environment to discuss and identify potential noncompliance, whether due to error or fraud, that could materially affect the subject matter. This meeting is also an opportunity to discuss the awareness of any ongoing investigations or legal proceedings and how to proceed with the audit giving consideration to the current circumstances that could materially affect the subject matter of the audit.

e. OIS auditors prepare audit leads and are required to provide the audit lead to the cognizant FAO. Additionally, OIS has procedures in place to reach out to the cognizant FAO when they get notice of an investigation.

#### **2-502.8 Results of Previous Engagements (2018 GAGAS 8.30) \*\***

a. Auditors should evaluate whether the audited entity has taken appropriate corrective action to address previous engagements findings and recommendations that are significant to the audit objectives. When planning the audit, auditors should ask auditee management to identify previous audits, attestation engagements, and other studies that directly related to the objectives of the audit, including whether corrective actions have been implemented. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the corrective action is applicable to the current audit objectives.

b. The auditor will document the results of these inquires and evaluate the information as part of the audit risk assessment.

#### **2-502.9 Audit Criteria (2018 GAGAS 8.17 – 8.19) \*\***

a. The criteria is used as the basis for evaluating the subject matter under audit. Criteria

represent the required or desired state or expectation with respect to a program. (2018 GAGAS defines a program as: processes, projects, studies, policies, operations, activities, entities, and functions of an operation). Criteria provide the context for evaluating evidence and understanding findings, conclusions, and recommendations in the report.

b. Auditors should identify suitable audit criteria to achieve the audit objectives. Criteria must be readily available to the auditee and the report user, and can be derived from laws, regulations, contracts, grant agreements, professional standards, specific program requirements, measures, expected performance, defined business practices, benchmarks, etc. Auditors should use suitable criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter.

c. Refer to 2-S103.3 for additional information on criteria.

**2-502.10 Evidence (2018 GAGAS 8.90 – 8.107, 8.12 – 8.13, and 8.16) \*\***

a. During planning, auditors should identify potential sources of information that could be used as evidence. Auditors should determine the amount and type of evidence needed to obtain sufficient, appropriate evidence to address the audit objectives and adequately plan the audit work given the audit risk and significance. See [3-204.15](#) (Types, Sources, and Relative Quality of Audit Evidence) for information on types of sources and quality of evidence.

b. Auditors must obtain sufficient, appropriate audit evidence to provide a reasonable basis for their findings and conclusions. In assessing the appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable. For example, when the audit objective is to report on the current status or condition of a process, appropriate evidence would provide reasonable assurance that the description of the current status or condition is accurate and reliable and does not omit significant information relevant to the audit objectives.

c. Appropriateness is the measure of the quality of the evidence that encompasses its relevance, validity and reliability in supporting audit objectives and related findings. In assessing the overall appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable. For oral testimony, the auditor evaluates the objectivity, credibility and reliability of the testimonial evidence. Strength of the oral testimony is generally higher when obtained under circumstances where the person is speaking freely than under conditions where the person may have felt intimidated.

(1) Relevance refers to the extent to which the evidence has a logical relationship and importance to the issue being addressed.

(2) Validity refers to the extent to which evidence is based on sound reasoning or accurate information.

(3) Reliability refers to the consistency of results when information is measured or tested and includes the concepts of being verifiable or supported.

d. Sufficiency is a measure of the quantity of evidence used to support the findings and conclusions related to the audit objectives. In assessing the sufficiency of evidence, auditors should determine whether enough appropriate evidence exists to address the audit objectives and support the findings and conclusions to the extent that would persuade a knowledgeable person that the findings are reasonable. The following presumptions are useful in judging the sufficiency of evidence. The sufficiency of evidence required to support the auditors' findings and

conclusions is a matter of the auditor's professional judgement.

(1) Greater the audit risk requires a greater quantity and quality of evidence.

(2) Stronger evidence may allow less evidence to be used.

(3) Having a large volume of audit evidence does not compensate for a lack of appropriate evidence, i.e., evidence that is relevant, valid, and reliable to meet the audit objective.

e. When sampling is used, the method of selection that is appropriate will depend on the audit objectives. When a representative sample is needed, the use of a statistical sampling approach generally results in stronger evidence than that obtained by nonstatistical techniques. See [3.204.15](#) (Types, Sources, and Relative Quality of Audit Evidence) and [4-600](#) (Section 6-Audit Sampling and Other Analytical Procedures) for guidance on statistical and nonstatistical approaches to audit sampling. For the judgmental selection methodology, see [4-602.1](#), Selection Methods That Are Not Sampling – Judgmental Selection). Requirements for working paper documentation are presented in 4-403g.

f. As discussed in 2-204 professional judgment is required to determine the sufficiency and appropriateness of evidence used to support the findings and conclusions and any recommendations reported as an integral part of the audit.

g. If the auditors believe that it is likely that sufficient appropriate evidence will not be available, they may need to revise the audit objectives, modify the scope and methodology, and/or determine alternative procedures to obtain additional or other forms of evidence to meet the audit objectives. Auditors should evaluate whether the lack of sufficient, appropriate audit evidence is due to internal control deficiencies or other program weaknesses, and whether the lack of sufficient, appropriate evidence could be the basis for audit findings.

h. In assessing evidence, professional judgment assists auditors in determining the sufficiency and appropriateness of the evidence as a whole, by evaluating the significance of evidence to the audit objectives, findings, and conclusions, considering corroborating evidence and the level of audit risk. For example, in establishing the appropriateness of evidence, auditors may determine the reliability by obtaining supporting evidence using statistical methods and also obtaining corroborating evidence through physical observations and/or oral testimony. In this example the results of each type of evidence would be considered together to determine the sufficiency and appropriateness of the overall evidence for the audit objective. The concepts of audit risk and significance assist auditors in evaluating the sufficiency and appropriateness of the evidence.

i. When auditors use information that the audited entity officials provided as part of their evidence, the auditor may find it necessary to test management's procedures to obtain assurance, perform direct testing of the information, or obtain additional corroborating evidence. The nature and extent of the auditor's procedures will depend upon the significance of the information to the audit objectives and the nature of the information being used. If evidence is identified during testing that contradicts the information provided by management, the auditor may use a risk-based approach to consider additional necessary procedures, and document how the conflicting evidence situation was resolved.

j. Auditors should assess the sufficiency and appropriateness of computer-processed information regardless of whether this information is provided by the audited entity or auditors

independently extract it. The nature, timing and extent of audit procedures to assess sufficiency and appropriateness is affected by the effectiveness of the auditee's internal controls over information, including information systems controls, the significance of the information for its intended use, and the level of detail presented in the auditors' findings and conclusions in light of the audit objectives. The assessment of the sufficiency and appropriateness of computer-processed information includes considerations regarding the completeness and accuracy of the data for the intended purposes.

k. Professional judgment assists auditors in determining the sufficiency and appropriateness of evidence taken as a whole. Interpreting, summarizing, or analyzing evidence is typically used in the process of determining the sufficiency and appropriateness of evidence and in reporting the results of the audit work. Auditors interpret the results of audit testing and evaluate whether the nature and extent of the evidence obtained is sufficient and appropriate to meet the audit objectives. The steps to assess evidence depend on the nature of the evidence, and how significant the evidence is to support the findings and conclusions. When appropriate, auditors may use statistical methods to analyze and interpret evidence to assess sufficiency.

l. Overall Assessment of Evidence. Auditors should perform and document an overall assessment of the collective evidence used to support findings and conclusions, including the results of any specific assessments performed to conclude on the validity and reliability of specific evidence. When assessing the overall sufficiency and appropriateness of evidence, auditors should evaluate the expected significance of the evidence to the audit objectives; available corroborating evidence; and the level of audit risk. Auditors should not use insufficient or inappropriate evidence as support for findings and conclusions.

m. Evidence is sufficient and appropriate when it provides a reasonable basis to support the findings or conclusions within the context of the audit objectives

n. Evidence is not sufficient or not appropriate when:

(1) using the evidence carries an unacceptably high risk that it could lead the auditor to reach an incorrect or improper conclusion,

(2) the evidence has significant limitations, given the audit objectives and intended use of the evidence, or

(3) the evidence does not provide an adequate basis for addressing the audit objectives or supporting the findings and conclusions.

Auditors should not use insufficient or inappropriate evidence as support for findings and conclusions.

o. Evidence has limitations or uncertainties when the validity or reliability of the evidence has not been assessed in context of the audit objectives or for its intended use. Limitations also include errors identified by the auditors during testing. When auditors identify limitations or uncertainties in evidence that is significant to the audit findings and conclusions, additional procedures should be performed as appropriate. Such procedures include:

(1) seeking independent corroborating evidence from other sources,

(2) redefining the audit objectives or limiting the audit scope to eliminate the need to use the evidence,

(3) presenting findings and conclusions that are based on supporting evidence that is sufficient and appropriate, and describing in the report the limitations or uncertainties with the validity or reliability of the evidence, if such disclosure is necessary to avoid misleading the report users about the findings or conclusions, and

(4) determining whether to report the limitations or uncertainties themselves as a finding, including any related significant internal control deficiencies.

p. Auditors should plan and perform procedures to develop the elements of a finding necessary to address the audit objectives. In addition, the auditors may develop recommendations for corrective action if they are significant to the audit objectives. The elements needed for a finding are related to the objectives of the audit. Thus, a finding or set of findings is complete to the extent that the audit objectives are addressed and the report clearly relates those objectives to the elements of the finding. The elements of a finding consist of criteria, condition, effect, and cause. See [10-211.2c](#) (Structured Notes) for a discussion of these elements in relation to the structured note Statement of Condition(s) and Recommendation(s) (SOCAR) format that is used for performance audits.

#### **2-502.11 Using the Work of Others Auditors (2018 GAGAS 8.80 – 6.44 and 8.86) \*\***

a. Auditors should determine whether other audits have been conducted or are being conducting on the program that could be relevant to the audit objectives. The results of other audit work may be useful sources of information for planning and performing the audit. If other audits identified areas that warrant further audit work or follow-up, those results may influence the current audit objectives, scope and methodology.

b. If other audits have been completed, the auditors may be able to use the work of the other auditors that are relevant to the objectives of the current audit to support findings or conclusions and to gain efficiencies and avoid duplication of efforts.

c. When using the work of another audit organization, the audit team should perform procedures that provide a sufficient basis for using that work. Refer to [4-1000](#) (Section 10- Relying Upon the Work of Others) for additional guidance on using the work of other auditors.

d. Some audits may necessitate the use of specialized techniques or methods that require the skills of a specialist. Specialists to whom this section applies include, but are not limited to actuaries, appraisers, attorneys, engineers, environmental consultants, statisticians, and information technology experts. If auditors intend to use the work of external specialists (i.e., not within DCAA), they should assess the professional qualifications and independence of the specialists. Independence is assessed by identifying threats and applying any necessary safeguards using the Independence Framework in 2018 GAGAS chapter 3. See [Appendix B](#) (Specialist Assistance) for guidance on requesting and evaluating the work of an internal or external specialist.

(1) DCAA internal specialists are under DCAA’s quality control program for independence and they evaluate independence in accordance with the requirements in 2-S103.1. Additional information on objectivity, competence and capability of DCAA internal specialists is in [Appendix B-103](#) (Evaluation of Competence, Capability and Objectivity – Internal Specialist).

(2) External specialists, such as a specialist who works for DCMA do not come under DCAA’s quality control program. See [Appendix B-104](#) (Evaluation of Competence, Capability and Objectivity – DCMA and DoD Military Command Specialists) and [B-105](#) (Evaluation of

Competence, Capability and Objectivity – DCMA Insurance/Pension Specialists) for the DCAA Headquarters-level assessment of objectivity (independence), competence and capability the external specialists employed by DCMA and DoD Military Commands.

e. Auditors planning to use the work of a specialist should document the nature and scope of the work to be performed by the specialist including:

- (1) the objectives and scope of the specialist’s work,
- (2) the intended use of the specialist’s work to support the audit objectives,
- (3) the specialist’s procedures and findings so they can be evaluated and applied to other planned audit procedures, and
- (4) the assumptions and methods used by the specialist.

**2-502.12 Communications (2018 GAGAS 8.20 – 8.26) \*\***

a. Auditors should communicate an overview of the objective, scope, methodology, and timing of the audit and planned reporting (including any potential restrictions on the report) to contractor management; to include individuals with sufficient authority and responsibility to implement corrective action in the program or activity being audited as well as the individuals contracting for or requesting the audit services.

b. Determining the form, content, and frequency of communication is a matter of professional judgment, although written communication is preferred. Auditors may use an engagement letter to communicate the information in paragraph a. and retain the communication in the audit file.

c. Chapter 4, [4-100](#), (Section 1-FAO Coordination with Procurement and Contract Administration Personnel) provides additional guidance on FAO coordination with procurement and contract administration personnel, and [4-302.3](#) (Contractor Notification Letter) provides guidance on contractor notification of the audit. Standard audit programs provide a proforma contractor notification letter and ACO acknowledgment-notification memorandum that may be used for this purpose.

**2-502.13 Preparing a Written Audit Plan (2018 GAGAS 8.33 – 8.35) \*\***

a. Written audit programs must be prepared for each audit and are essential to conducting audits efficiently and effectively. During the course of the audit, the audit plan should be updated, as necessary, to reflect any significant changes to the plan during the audit. The audit plan documents the significant decisions about the audit objectives, scope and methodology and the auditor’s basis for those decisions. Audit programs provide:

(1) A description of the audit methods and audit steps and procedures to be conducted to meet the audit objectives.

(2) A systematic basis for assigning work and supervising the audit staff to ensure that enough staff, supervisors, and specialists with adequate collective professional competence are assigned to the audit and ensuring necessary resources are available to conduct the audit to meet the expected time frame.

(3) Audit objects that are likely to result in a useful report,

(4) Adequately addressing relevant risks,

(5) Ensuring that the audit scope and methodology are adequate to address the audit objectives and the available evidence is likely to be sufficient and appropriate, and.

(6) The basis for a summary record of work.

b. See [3-203](#), The Audit Program for general information on the audit program and [14-500](#), Section 5 – Performance Audits for additional information on audit planning and audit programs.

**2-503 Supervision (2018 GAGAS 8.87-8.89) \*\***

a. Auditors, (i.e., the audit supervisors or other auditors designated to supervise auditors) must properly supervise the audit staff. Audit supervision involves assigning staff with the collective knowledge, skills, and experience appropriate for the job, assigning individuals who, prior to beginning work on the engagement, possess the competence needed for their assigned roles, engaging specialists when needed, providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable standards, staying informed about significant problems encountered, reviewing the work performed for compliance with GAGAS, and providing effective on-the-job training. The nature and extent of the supervision of staff and the review of audit work may vary depending on a number of factors, such as the size of the audit organization, the significance of the work, and the experience of the staff.

b. Supervisory reviews of audit work and the report should be timely and must be performed and documented in the working papers before the report is issued. Supervisory reviews of the evidence that supports the findings, conclusions and recommendations contained in the audit report should include verification that:

- (1) auditors complied with the auditing standards,
- (2) the audit program adequately addresses relevant risks,
- (3) the proposed audit scope and methodology are adequate to address the audit objectives,
- (4) the audit program is appropriately modified to meet the audit objectives and is approved by the supervisor including any subsequent changes to the audit program,
- (5) the working papers adequately support findings and conclusions,
- (6) the working papers provide adequate evidence to prepare a meaningful report, and
- (7) the audit team accomplished the audit objectives.

c. See [DCAAI 7642.2](#), Management Review and Technical Support of Audits for additional guidance.

**2-504 Audit Documentation (2018 GAGAS 8.132 – 8.139) \*\***

a. Auditors must prepare audit documentation related to planning, conducting, and reporting for each audit. Working papers should contain sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the working papers the nature, timing, extent, and results of procedures performed and the evidence obtained and its source and the conclusions reached, including evidence that supports the auditor's significant judgments and conclusions.

b. Auditors should design the form and content of audit documentation to meet the circumstances of the particular audit. The audit documentation constitutes the principal record of the work performed in accordance with standards and the conclusions reached. The quantity, type, and content of audit documentation are a matter of professional judgment.

c. Audit documentation is an essential element of audit quality. The process of preparing and reviewing audit documentation contributes to the quality of an audit. Audit documentation serves to:

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

d. GAGAS requires auditors to document the following:

- (1) the objectives, scope, and methodology of the audit,
- (2) the work performed and evidence obtained to support significant judgments and conclusions, as well as expectations in analytical procedures, including descriptions of transactions and records examined; (for example by listing file numbers, case numbers, or other means of identifying specific documents examined, but copies of documents examined or detailed listings of information from those documents are not required) (see 4-400 guidance on documentation of working papers),

- (3) evidence of supervisory review, before the audit report is issued, of the evidence that supports findings, conclusions, and recommendations contained in the audit report, and

- (4) departures from any applicable GAGAS requirements (due to law, regulation, scope limitations, restriction on access to records, or other issues impacting the audit) and the impact on the audit and on the auditor's conclusions. This applies to departures from unconditional requirements (i.e., must) as well as presumptively mandatory (i.e., should) requirements when alternate audit procedures performed in the circumstances were not sufficient to achieve the objectives of the standard. These circumstances would generally require a modified statement of GAGAS compliance (see 2-603.6).

e. Underlying GAGAS audits is the premise that audit organizations in federal, state, and local governments and public accounting firms engaged to perform audits in accordance with GAGAS cooperate when auditing programs of common interest so that auditors may use others' work to avoid duplication of efforts. Subject to applicable laws and regulations, auditors should make appropriate individuals as well as audit documentation available upon request and in a timely manner to other auditors or reviewers to satisfy these objectives. See [1-203](#), GAO Access to Records and Files, for guidance on providing access to DCAA audit files to the Government Accountability Office, and [1-404.2](#), DCAA Assistance to Government Internal Audit Organizations for guidance on providing access to the DoD OIG and other executive branch internal audit organizations.

## **2-600 Section 6 – Reporting Standards for Performance Audits (DCAA Operations Audits) \*\***

### **2-601 Introduction (2018 GAGAS 9.01 – 9.02) \*\***

The Yellow Book establishes reporting standards and provides guidance for performance audits conducted in accordance with GAGAS. This section discusses reporting the auditors' compliance with GAGAS, the form of the report, report contents, and report issuance and distribution of performance audit reports.

### **2-602 Reporting (2018 GAGAS 9.06 – 9-09, 9-68) \*\***

a. Auditors should issue audit reports communicating the results of each completed performance (e.g., operations) audit. DCAA communicates the results of performance audits by issuing an audit report (see also [14-505](#), Conferences and Reports on Operations Audits) transmitted to the report recipients in accordance with [4-407d\(4\)](#), Computer-Aided Working Papers.

b. The purposes of the DCAA performance audit reports are to:

(1) Communicate the results of audits to the appropriate cognizant federal agency official(s) (CFAO) responsible for oversight of the contractor.

(2) Make the results less susceptible to misunderstanding.

(3) Facilitate follow-up to determine whether appropriate corrective actions have been taken.

c. If an audit is terminated before it is completed follow the procedure in [4.403f](#), (Format and Contents of Working Papers).

d. If, after the report is issued, the auditors discover that there is not sufficient, appropriate evidence to support the reported findings or conclusions, they should communicate this in the same manner as the original report was distributed to report recipients to notify them to not rely on the findings or conclusions that were not supported in the original report. The auditors should then determine whether to conduct additional audit work necessary to reissue the report, including any revised findings or conclusions, or to redistribute the original report if the additional audit work does not result in a change in findings or conclusions.

### **2-603 Report Contents (2018 GAGAS 9.10 – 9.14) \*\***

Auditors should prepare audit reports that describe:

- the objectives, scope, and methodology of the audit;
- the audit results with findings, conclusions, and recommendations, as appropriate;
- a statement about the auditors' compliance with GAGAS; and,
- a summary of the views of responsible officials of the audited entity.
- If applicable, the auditor should also describe the nature of any confidential or sensitive information that was omitted from the report.

#### **2-603.1 Objectives, Scope and Methodology (2018 GAGAS 9.15 – 9.17) \*\***

a. The report should communicate the audit objectives in a clear, specific, neutral and

unbiased manner that includes relevant assumptions including the purpose of the audit and report. When audit objectives are limited but broader objectives could be inferred by users, auditors should state in the audit report that certain issues were outside the scope of the audit in order to avoid potential misunderstanding.

b. In reporting the audit scope, auditors should describe the scope of the work performed and any limitations, including issues that are relevant to likely users, so they can reasonably interpret the findings, conclusions, and recommendations in the report without being misled. Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials or excessive delays of access to records or individuals.

c. When describing the work performed to address the audit objectives and support the reported findings and conclusions, auditors should, as applicable, explain the relationship between the population and the items tested; identify organizations, geographic locations and the period covered; report the kinds and sources of evidence; and explain any significant limitations or uncertainties based on the auditors' overall assessment of the sufficiency and appropriateness of the evidence in the aggregate.

d. In reporting audit methodology, auditors should explain how the completed audit work supports the audit objectives, including the evidence-gathering and analysis techniques, in sufficient detail to allow knowledgeable users of the report to understand how the auditor addressed the audit objectives. Auditors may include a description of the procedures performed as part of their assessment of the sufficiency and appropriateness of the information used as audit evidence. Auditors should identify significant assumptions made in conducting the audit, describe comparative techniques applied, describe the criteria used, and when sampling significantly supports the auditors' findings, conclusions, or recommendations, describe the sample design and state why the design was chosen, including whether the results can be projected to the intended population.

## **2-603.2 Audit Findings Conclusions, and Recommendations (2018 GAGAS 9.24-9.28) \*\***

### **2-603.2.1 Findings \*\***

a. The report should present sufficient, appropriate evidence to support the findings within the context of the audit objectives. Auditors should place the findings in perspective by describing the nature and extent of the issues and the extent of the work performed. The report should give the reader a clear basis for judging the prevalence and consequences of the findings. It should describe limitations or uncertainties about the reliability or validity of the evidence to avoid misleading the reader about the findings and to provide relevant background information to establish the context of the findings. Clearly developed findings assist the responsible Federal agency, as well as the contractor's management, in understanding the need for corrective action.

b. To give the reader a basis for judging the prevalence and consequences of these findings, auditors should, as applicable, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value, or other measures, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

c. Auditors may provide background information to establish the context for the reader

to understand the findings and the significance of the issues discussed. Appropriate background information may be included, such as: operation processes; significance of the operations (e.g. dollars, impact, purposes, past audit work, if relevant); a description of the audited entity's responsibilities; explanation of terms; organizational structure; and the statutory basis for the program or operations. When reporting audit results, auditors should disclose significant facts relevant to the audit objectives which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal significant improper or illegal practices.

d. When developing the elements of a finding, the auditors may provide recommendations for corrective action if they are significant to the audit objectives. The extent to which the elements for a finding are developed depends on the audit objectives. The auditor should consider internal control deficiencies in their evaluation of identified findings when developing the cause element of the finding when internal control is significant to the audit objectives. Thus, a finding or set of findings is complete to the extent that the auditors address the audit objectives.

e. See [10-104](#), Good Writing Techniques for Effective Audit Reports for general guidance on good writing techniques for effective audit reports.

f. The audit report should describe limitations or uncertainties regarding the sufficiency or appropriateness of evidence in conjunction with the findings and conclusions in addition to describing them as part of the objectives, scope and methodology. Describing the limitations and uncertainties provides report users with a clear understanding regarding how much responsibility the audit team is taking for the information. The report should describe limitations or uncertainties with the reliability or validity of the evidence if:

(1) the evidence is significant to the findings and conclusions within the context of the audit objectives; and

(2) such disclosure is necessary to avoid misleading report users about the findings and conclusions.

Even though the audit team may have some uncertainty with the sufficiency or appropriateness of some of the evidence, they may nonetheless determine that in total there is sufficient appropriate evidence to support the findings and conclusions.

### **2-603.2.2 Conclusions \*\***

Auditors should report conclusions based on the audit objectives and the audit findings. Report conclusions are logical inferences about the subject matter under audit based on the auditor's findings, not merely a summary of the findings. The strength of the conclusions depends on the persuasiveness of the evidence supporting the findings and the soundness of the logic used to formulate the conclusions. Conclusions are more compelling if they lead to the auditor's recommendations and convince the user of the report that action is necessary.

### **2-603.2.3 Recommendations \*\***

a. When feasible, auditors should recommend actions to correct deficiencies and other findings that are significant to the audit objectives when identified during the audit and to improve programs and operations when the potential for improvement in programs operations and performance is substantiated by the reported findings and conclusions. Effective recommendations encourage improvements in the conduct of programs and operations.

Recommendations should flow logically from the findings and conclusions and be directed at resolving the cause of the identified deficiencies and findings. Strong recommendations also provide the report user and the audited entity with constructive, specific information to enable the contractor to determine an appropriate corrective action. Auditors must not make recommendations for corrective actions that direct the contractor “how” to correct the deficiency, which would be considered a management decision.

b. See [10-211.2c](#), Structured Notes for additional information on reporting recommendations using the Statement of Condition(s) and Recommendation(s) (SOCAR) format and [14-504](#), Cost Avoidance Recommendation Resulting From Operations Audits for guidance on computing and reporting on cost avoidance recommendations resulting from a performance audit.

### **2-603.3 Reporting on Internal Control (2018 GAGAS 9.29-9.34) \*\***

a. 2018 GAGAS 9.29 – 9.34 outline the requirements for reporting the scope of work performed on internal controls and deficiencies in internal controls that are significant to the audit objectives. If only some of the internal control components (i.e., the COSO framework components), the components that are significant to the audit objectives should be included in the description of the scope of the audit.

b. When auditors detect deficiencies in internal control that have occurred or are likely to have occurred, and that are significant to the audit objectives, the audit report should include:

(1) the scope of work performed on internal control, and

(2) any deficiencies in internal control that are significant to the audit objectives and based upon the audit work performed.

c. When auditors detect deficiencies in internal control that are not significant to the audit objectives, but warrant the attention of CFAO, the deficiencies can be communicated either in the report or through a separate memorandum to the appropriate CFAO with responsibility for oversight of the audited entity. If the auditors have communicated deficiencies in a separate memorandum to the CFAO, the audit report should refer to that memorandum.

d. When auditors detect deficiencies that are clearly inconsequential considering both qualitative and quantitative factors, and do not warrant the attention of appropriate Government officials, the determination on whether or how to communicate the deficiencies is a matter of professional judgment. If the auditors have communicated deficiencies in a separate memorandum to the CFAO, the audit report should refer to that memorandum.

### **2-603.4 Reporting on Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements (2018 GAGAS 9.35 – 9.39) \*\***

a. 2018 GAGAS 9.35 – 9.39 outlines the requirements for reporting noncompliance with provisions of laws, regulations, contracts and grant agreements to those charged with governance of the audited entity. DCAA reports findings of noncompliance to the ACO that requested the audit or is responsible for oversight of the audited entity.

b. 2018 GAGAS presents different levels of reporting for instances of noncompliance:

(1) those that are significant to the audit objectives,

(2) those that are not significant but require the attention of those charged with

governance, and

(3) those that are clearly inconsequential

c. Significant Noncompliance. When auditors conclude, based on sufficient, appropriate evidence, that noncompliance with provisions of laws, regulations, contracts, or grant agreements either has occurred, or is likely to have occurred, and is significant to the audit objectives they should report the matter as a finding. DCAA reports findings by issuing an audit report to the contracting officer responsible for taking action on finding. The contracting officer provides a copy of the report to the contractor. Buying commands that will be materially impacted by the report findings can also be on distribution of the audit report.

d. Less Than Significant. DCAA auditors communicate instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements that are not significant to the audit objectives, but warrant the attention of the CFAO with responsibility for oversight of the audited entity, in either a separate memorandum to the CFAO or in the audit report. Noncompliances communicated through a separate memorandum should be referenced in the audit report.

e. Clearly Inconsequential. When auditors detect instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements that are clearly inconsequential (considering both qualitative and quantitative factors) in relation to the audit objectives, and therefore do not warrant the attention of the CFAO, the noncompliance should not be included in the audit report, and the determination of whether and how to communicate such instances to the CFAO is a matter of professional judgment.

#### **2-603.5 Reporting on Instances of Fraud (2018 GAGAS 9.40 – 9.44) \*\***

a. DoD Instruction 7600.02; *Audit Policies*, Enclosure 3, Item No. 3, requires DCAA to refer indications of potential fraud or other criminal acts to the appropriate investigative organization. Therefore, when suspected fraud or irregularities are discovered, DCAA policy is for the auditor to report it separately (see [4-700](#), Section 7-Responsibilities for Detection and Reporting of Suspected Irregularities). 2018 GAGAS 9.44 allows the auditor to limit public reporting of fraud or suspected fraud.

b. Auditors should report a finding when they conclude, based on sufficient, appropriate evidence, that fraud either has occurred, or is likely to have occurred, and is significant to the audit objectives. Auditors may consult with authorities or legal counsel about whether reporting such information would compromise investigative or legal proceedings.

c. For instances of fraud that are not significant to the audit objectives, but warrant the attention of the CFAO with oversight responsibility for the audited entity, the instances may be communicated in a separate memorandum to the CFAO.

d. Whether a particular act is, in fact, fraud, may have to await final determination by a court of law or other adjudicative body.

#### **2-603.6 Reporting Auditor's Compliance with GAGAS (2018 GAGAS 9.03 – 9.05) \*\***

a. When the auditor complies with all applicable GAGAS requirements, an unmodified statement of GAGAS compliance will be included in the audit report. The proforma audit report in the standard audit program provides the language required by 2018 GAGAS for the unmodified statement.

b. When auditors do not comply with all applicable GAGAS requirements, a modified statement of GAGAS compliance will be included in the audit report. For performance audits, the auditor will modify the statement of GAGAS compliance in the proforma audit report to indicate the requirements that were not followed, or other language indicating the auditors did not follow GAGAS, e.g., because of significant departures from the requirements, the auditor was unable to perform the audit in accordance with GAGAS.

c. When auditors use a modified compliance statements, a scope limitation is also frequently present, such as restrictions on access to records, or access to government officials or other individuals needed to perform the audit. When auditors use a modified statement of GAGAS compliance, the report should disclose the applicable requirement(s) not followed and the impact on the audit objectives and/or scope of the audit resulting from departure from the requirements, and the level of assurance provided.

### **2-603.7 Obtaining the Views of Responsible Officials (2018 GAGAS 9.50 – 9.55) \*\***

a. Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations included in the audit report, as well as any planned corrective actions.

b. Auditors should provide a draft report with findings to the responsible officials of the audited entity for review and comments. This assists in developing a report that is fair, complete, and objective. Written comments are preferable, but oral comments are acceptable.

c. When auditors receive written comments from the responsible officials, the comments should be summarized in the report and a copy of the full written comments included as an appendix to the report. When the responsible officials respond with oral comments only, auditors should prepare a summary of the oral comments for inclusion in the audit report. The summary should be provided to the responsible official for confirmation that the summary of the comments is fairly stated prior to issuing the audit report.

d. When the audited entity's comments are inconsistent or in conflict with the findings, conclusions or recommendations in the draft report, the auditor should evaluate the validity of the audited entities comments and explain the reasons for the disagreement in the audit report. If the auditor finds the comments to be valid and supported with sufficient, appropriate evidence, the audit report should be appropriately modified.

e. Obtaining oral comments may be appropriate in situations such as: meeting a reporting date that is critical to the user's needs; the auditors have worked closely with the responsible officials throughout the work and the parties are familiar with the findings and issues addressed in the draft report; when the auditors do not expect major disagreements from the entity's officials regarding the findings, conclusions, and recommendations in the draft.

f. In cases where the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received.

g. If the audited entity refuses or is unable to provide comments within a reasonable period of time, the audit report should indicate that the audited entity did not provide comments.

h. See [4-304.5](#), Operations Audits – Exit Conferences for information on obtaining comments from responsible officials and 10-208.5d for information on reporting those

comments.

### **2-603.8 Confidential and Sensitive Information (2018 GAGAS 9.61 – 9.67) \*\***

a. 2018 GAGAS 9.61 – 9.67 outlines the requirements for reporting on confidential and sensitive information for publicly available reports and in circumstances where information is omitted from the audit report (e.g., classified or sensitive information). Performance audit reports issued by DCAA are issued to the federal official that requested the audit and are not made publicly available.

b. In circumstances where information must be omitted from the audit report, (for example, classified information) auditors should evaluate if the omission could distort the results or conceal improper acts and revise the report language as necessary to avoid report users from drawing inappropriate conclusion based on the information that is contained in the report. If the report refers to the omitted information, the reference may be general and not specific. If the omitted information is not necessary to meet the audit objectives, the report need not refer to its omission.

c. Auditors should consider the potential public availability of classified or limited use performance audit reports through public records laws (e.g., FOIA) when determining whether confidential or sensitive information should be included in the audit report, or whether it should be issued under a separate classified or limited use report containing the information that is classified or may otherwise be prohibited from general disclosure by federal, state, or local laws, and distribute the report only to persons authorized by law or regulation to receive it (GAGAS 9.65).

d. The auditor may consult with legal counsel regarding applicable public records laws and any requirements or other circumstances that may necessitate the omission of certain information. See 1-700 for more information about the Freedom of Information Act.

e. DCAA audit reports may contain contractor propriety information that if disclosed to the public, would reasonably be expected to cause harm to the interested parties. The proforma audit report delivered with the standard audit program contains the “CUI” marking to indicate the report contains unclassified information requiring safeguarding and dissemination controls, consistent with applicable law, regulation, or government-wide policy.

f. See [1-507](#), Security Requirements for Contract Information for additional information on security requirements for contractor information and [10-210.2](#), Report Restrictions – General for additional general information on audit report distribution restrictions.

### **2-603.9 Report Quality Elements (2018 GAGAS 9.17) \*\***

2018 GAGAS 9.17 presents report quality elements to assist the auditor in developing and writing the performance audit report. Report quality elements include being accurate, objective, complete, convincing, clear, concise and timely, as the subject matter permits.

(1) An accurate report is supported by sufficient, appropriate evidence with key facts, figures, and findings that are traceable to the audit evidence.

(2) An objective report presents language in a balanced in content and tone.

(3) A complete report contains sufficient, appropriate evidence to satisfy the audit objectives and promote an understanding of the matters reported. It also does not omit significant

relevant information related to the audit objectives.

(4) A convincing report is responsive to the audit objectives, presents findings persuasively, and the conclusions and recommendations flow logically from the facts presented.

(5) A clear report is easy for the user to read and understand.

(6) A concise report is no longer than necessary to convey and support the message.

(7) The auditor's goal is to provide relevant information within the timeframe to meet the needs of the intended user. Throughout the audit, the auditors should communicate significant matters to appropriate entity and oversight officials. Such communication alerts officials to matters needing immediate attention and allows them to take corrective action before the final report is completed. When corrective action is taken before the report is issued, the auditor will, nonetheless, include the finding in the audit report and may comment on corrective actions taken by the contractor.

#### **2-604 Report Distribution (2018 GAGAS 9.56) \*\***

a. 2018 GAGAS 9.56 recognizes that distribution of audit reports depends on the relationship of the auditor to the audited organization and the nature of the information contained in the report. Because DCAA does not perform audits for the audited entity, DCAA policies and procedures establish that reporting of deficiencies and noncompliances are issued to the CFAO who has responsibility for oversight of the audited entity, not to the management or governance body of the audited entity. Other Federal 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 may also be on distribution of the audit report (e.g., PCOs, CACOs). When Field Detachment will be receiving the report, provide the report as a blind copy and do not list them on the audit report distribution page.

b. Auditors should document any limitations on report distribution.

c. Chapter 10, [10-210.2](#), Report Restrictions – General, specifies disclosure restrictions applicable to audits performed by DCAA.

d. In addition to the general distribution guidance shown in [10-200](#), Section 2-Audit Report Format and Contents (General), [15-100](#), Section 1 – Special Procedures for Non-DoD Agencies provides general guidance for distribution requirements pertaining to non-DoD agencies and [Table 15-1S6](#), Supplement – Additional Report Distribution Requirements for Non-DoD Organizations provides distribution requirements specified by the non-DoD organizations.

#### **2-S10 Supplement – Description of DCAA Quality Control System \*\***

##### **2-S101 Introduction \*\***

DCAA's quality control program is an important element of the Agency's overall focus on quality which emphasizes "prevention" as a means for reducing errors and rework. 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 to 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 necessary accounting and financial advisory services for the DoD, and other agencies by serving the public interest as its primary customer and ensuring that taxpayer dollars are spent on fair and reasonable contract prices. In accomplishing this mission, the Director of DCAA has fully committed the Agency staff to attain the highest level of integrity and competence. This is best explained through our vision statement set forth as follows:

*Dedicated professionals working together to deliver top-quality audit services to support the Department and the warfighter and to protect the taxpayer's interest.*

Good working relationships and open communications with our stakeholders will minimize potential conflicts between their 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, four Assistant Directors (Policy, Operations, Quality and Human Capital and Resource Management (Resources)), a General Counsel and a Chief of Staff. 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). Resources serves as the focal point for developing regulations and guidance, accumulating information, and drafting the Director's annual statement required under the FMFIA. Resources monitor tests of critical management controls performed by others as reported through the FMFIA process. Resources also advises the Director and Deputy Director on any sensitive matters disclosed by quality or management control reviews reported through the FMFIA process.

#### **(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), Incurred Cost (PIC), and Pricing and Special Projects (PSP). DCAA's auditing standards subject matter experts (a Division Chief and several program managers) reside in the PAS Division. PAS is dedicated solely to activities related to the development and formulation of DCAA's contract audit policy for compliance with auditing standards (GAGAS, SSAEs, SAS, etc.), including but not limited to the following program areas: independence (including advisory services), professional judgment, competence, planning and supervision, auditor communication, sufficient evidence/adequate testing, internal controls, assessing the risk of fraud, audit documentation, reporting, and agreed-upon procedures. For example, PAS monitors and researches relevant auditing standards and develops or revises guidance as needed; develops or provides advice on the development of training related to auditing standards; responds to inquiries from Regional offices, Corporate Audit Directorates (CADs), and field offices; identifies problems with implementation of guidance and determines the need for revision; reviews the work of other Policy divisions for compliance with auditing standards; and provides technical assistance to other Headquarters elements on issues with auditing standards implications. When appropriate, PAS seeks advice from the GAO on the interpretation and implementation of GAGAS related to complex audit policy issues and unusual independence questions using the contact information for technical and practice questions posted to the [GAO website](#). PAS also consults with other organizations, such as the AICPA and DoDIG, to obtain technical advice on auditing standards issues.

(c) Human Capital and Resource Management. 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.

(d) Integrity and Quality Assurance. Responsible and accountable for monitoring the system of quality control and providing the Agency with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively and complied with in practice.

b. Regional Offices or Corporate Audit Directorates and Field Detachment

(1) Office of the Regional Director or Corporate Audit Director. DCAA presently has three Regional Directors and four Corporate Audit Directors who are individually responsible and accountable to the Director for planning, managing, and accomplishing the Agency's mission in assigned geographical or corporate areas. This includes directing the overall management of DCAA personnel and resources assigned to the individual Regional Offices or CADs and to the various Field Audit Offices (FAOs) and suboffices within the regions/CADs. Each Director's staff includes a Deputy, several Regional/Corporate Audit Managers, a Special Programs Manager, a Resources Manager/Liaison, and a Special Assistant to the Director.

(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, and a Special Assistant to the Field Detachment Director.

### (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 of 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 or CAD 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, Inspector General, Regional Directors, Corporate Audit Directors, and Director, Field Detachment. The Chief of Staff and Chief, Enterprise Communications provides staff support to the ESC. The purpose of the ESC is to establish the vision and strategic goals for the Agency; monitor the attainment of the goals and identify, evaluate, and make recommendations on Agency-wide policy and improvement projects.
- 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.

### **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 and maintained in the Electronic Contractor Permanent File (ECPF).

- 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 and Ethical Requirements \*\***

#### **a. Objective**

To establish policies and procedures on independence, legal and ethical requirements to provide reasonable assurance that the audit organization and its personnel maintain independence and comply with applicable legal and ethical requirements in GAGAS 5.08.

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

##### **(1) General Requirements**

(a) DCAA employees at all organizational levels must adhere to the requirements on independence as stated in the GAGAS general standards, DCAA Instructions, Contract Audit Manual (CAM), and Personnel Management Manual (PMM). 2-203 implements guidance on the GAGAS general standard pertaining to independence and the following quality control policies and procedures, which prescribe the DCAA auditor's and internal specialist's responsibilities for independence when performing work on audits.

(b) Auditors and internal specialist should evaluate their independence in relation to all contractors under their assigned FAO's cognizance. Regional and CAD personnel should evaluate their independence in relation to all contractors audited by the region/CAD. For HQ personnel, this evaluation should consider all contractors audited by the Agency.

(c) It is DCAA's policy that auditors and internal specialists must immediately

notify their supervisor in writing, if they believe they have or may have a threat to independence of mind or in appearance. The supervisor should take action to resolve the identified threat or potential impairment in a timely manner.

(d) No auditor or internal specialist with a significant threat to independence will be permitted to work on any assignment affected by the significant threat. In these cases, employees may be reassigned or rotated without change in grade to assure independence.

(e) Auditors and internal specialists should re-evaluate their independence when facts and circumstances change including changes to their personal situation (e.g., marital status changes, spouse changes employer) or upon temporary or permanent reassignment to another office. Auditors and internal

(f) Audit Specific Re-evaluation. Auditors and internal specialists should re-evaluate their independence for each individual audit in which they perform procedures or consult on. If the re-evaluation did not identify any independence threats, the auditor or internal specialist should complete the Audit Specific Independence Determination working paper (W/P 34) documenting his or her independence in relation to performing the audit. Generally, the CaseWare file should be generated upon initiation of an engagement and auditors and internal specialist should be given access to the CaseWare file as soon as they are assigned to an engagement. CaseWare includes an automated W/P 34 process which only allows the user to access the working papers once they have completed the automated process indicating they are independent. CaseWare also delivers a PDF version of W/P 34 to be used in unique situations where the team member does not access the CaseWare file. Generally, team members who performed work or consulted on an audit during the preliminary (including early engagement) and planning phases should sign the W/P 34 prior to risk assessment approval. In all other cases (e.g., when an auditor is assigned to an audit during fieldwork), the W/P 34 should be signed prior to final audit report or memo approval.

(g) DCAA employees are expected to always act professionally, objectively and without bias when performing audits and dealing with contractor personnel. DCAA management recognizes that disagreements between contractors and auditors over audit issues and the conduct of audits often occur (e.g., regarding access to records) and that such disagreements are not an indicator of potential independence impairment (e.g., bias). However, DCAA management should promptly investigate credible complaints regarding inappropriate behavior toward contractor representatives that would indicate a lack of audit objectivity. The resolution of the complaint should be documented.

## (2) Documentation Requirements

### (a) Documentation of GAGAS Independence Threats.

Auditors should use the Agency's [Documentation of GAGAS Independence Threats](#) template to notify their supervisor in writing when they have identified facts or circumstances that creates threats that may impair their independence in relation to an assigned audit, in-process audits, or potential future audits. The auditor is responsible for completing and signing Section I, and submitting the document to his or her supervisor. The supervisor is responsible for completing Section II to document the results of the evaluation and the rationale for the conclusions reached. If applicable, the supervisor will document the application of safeguards in Section III. The employee will acknowledge the evaluation and conclusions

reached in Section IV.

(b) Notice of Recusal. Auditors and internal specialists should use the [Memorandum for Notice of Recusal](#) to communicate situations where the application of safeguards cannot eliminate or reduce the threat risk to an acceptable level.

(c) Audit Specific Independence Determination. Auditors and internal specialist are required to re-evaluate their independence in relation to each specific audit they perform work or consult on. If no threats are identified, the auditor or internal specialist should complete the Audit Specific Independence Determination work paper (W/P 34) to document they have not identified any threats to independence in relation to the specific assignment. If threats are identified, the auditor or internal specialist should immediately cease work on the assignment, notify their supervisory, and follow the procedures for documenting independence threats as prescribed in sub-paragraphs (a) and (b) above.

(d) Annual Affirmation of Compliance. Auditors and internal specialist are required to provide an annual written affirmation of retrospective compliance with the Agency's policies and procedures on independence. This affirmation is obtained during the annual independence training process.

### (3) Mandatory Annual Training

All audit staff and internal specialists (e.g. DL attorney-advisors who support audits, OTST industrial engineers, and operations research specialists) must complete mandatory independence training upon entering employment with the Agency and annually thereafter. The annual independence training serves to:

- Provide knowledge concerning the GAGAS independence standards and related ethical principles.
- Describe the GAGAS conceptual framework to independence.
- Explain auditors' and internal specialists' responsibilities for evaluating, documenting, and reporting independence threats.
- Explain supervisors' responsibilities upon notification of a threat.
- Prompt personnel to evaluate and/or re-evaluate their independence using the GAGAS conceptual framework.
- Capture auditors' and internal specialists' affirmation of compliance with the Agency's independence policies and procedures.

### (4) Actions taken by Supervisor Upon Notification of a Threat

The supervisor will take action to resolve any identified independence threats in a timely manner. The actions taken by the supervisor to address identified threats to independence will vary depending on whether identification of the threat or potential independence impairment occurred upon completion of the training, before the performance of work on the audit, during the performance of the audit, or after report issuance.

#### (a) Upon Completion of Training or Before Performance of Audit Work.

When the supervisor is informed of a threat to an auditor's independence, the supervisor should review Section I of the "[Documentation of GAGAS Independence Threat](#)"

document signed and submitted by the auditor or internal specialist using the following procedures:

(i) Discuss the identified threat with the auditor or internal specialist, evaluate the significance of the threat, and document the results of the evaluation and the rationale for the conclusions reached in Section II of the “Documentation of GAGAS Independence Threat” document.

(ii) If application of safeguards is necessary, document the safeguards applied to eliminate or reduce the threat to an acceptable level and explain why the safeguard is effective in Section III of the “Documentation of GAGAS Independence Threat” document.

(iii) If it is determined, the auditor or internal specialist needs to disassociate him or herself from the audit, or from audits of the contractor, the file documentation should include a copy of the employees disqualification letter.

(iv) Digitally sign the “Documentation of GAGAS Independence Threat” document in Section III, regardless of whether safeguards are applied or not.

(b) During the Performance of the Audit.

If informed of a threat to independence during an audit, the supervisor should take the following actions:

(i) Immediately notify DCAA Headquarters, PAS of the issue through the regional office.

(ii) Ensure the auditor or internal specialist immediately ceases working on any affected engagements pending a determination of the significance of the threat.

(iii) Follow the procedures outlined above in paragraph (4a) to document and evaluate the threat and, if the threat is significant, document the safeguards applied.

(iv) If the threat is significant, assess the impact on the work already performed on the affected in-process engagements and determine what actions are necessary to ensure the audits comply with GAGAS.

(v) Document the impact assessment, including the rationale for the conclusions.

(vi) Coordinate the impact assessment and any other actions to be taken regarding the in-process audits with DCAA Headquarters (PAS) through the regional office.

(c) After Report Issuance. If a threat to independence is identified after issuance of the audit report, GAGAS 3.34 requires an evaluation of the threats impact on the audit and on GAGAS compliance. If it is determined the threat was significant, the standards require the auditor provide written notice to the parties to whom the report was distributed and rescind the report. This will ensure the report users are not relying upon audit conclusions that may be impacted by the significant threat to independence. In addition, auditors are required by the standards to perform an assessment to determine if additional audit work is necessary to reissue the audit report, including any revised findings or reissue the original report if the additional audit work does not result in a change in findings or conclusions. When a threat to independence is identified after report issuance, the supervisor should:

(i) Immediately notify DCAA Headquarters, PAS of the issue through the regional office.

(ii) Evaluate the threat, using the GAGAS conceptual framework and document the evaluation including the rationale for the conclusions reached.

(iii) If the threat is significant, draft a written notice to the parties to whom the report was distributed. The written notice should indicate a significant threat to independence existed during the performance of the audit. In addition, the written notice should explain the report is being rescinded. The written notice should include all pertinent information including that an assessment is being conducted to determine the impact on the audit and whether it will be necessary to conduct additional audit work to reissue the report.

(iv) Coordinate the notice with DCAA Headquarters, PAS through the regional office before making any notifications to the report recipients.

(v) Perform the assessment of the impact the threat had on the audit report and determine what additional audit work is necessary to reissue the audit. Document the assessment including the rationale for the conclusions, and a description of the additional audit work to be performed.

(vi) Coordinate the impact assessment with DCAA Headquarters PAS through the regional office.

(vii) Upon completion of the additional audit work, reissue the report, including any revised findings or conclusion or reissue the original report if the addition audit work did not change the findings.

#### (5) Ethics Requirements

GAGAS also requires all auditors and internal specialists 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". In a particular case, if either of the GAGAS independence or the ethics requirements are more restrictive than the other is, the auditor or internal specialist must follow the more restrictive rule.

#### (6) Seeking Advice

An auditor or internal specialist who thinks he or she may have a threat to independence of mind or in appearance that would be significant and create an impairment should inform his or her supervisor in writing and discuss it with the supervisor promptly. When an independence or ethics question cannot be answered at the local level, the field audit office should provide the facts and circumstances, including its evaluation of the issue, to the regional office and request a determination from the regional office. If the regional office is uncertain, it should forward the facts and circumstances and the regional analysis of the issue to Headquarters. Since most independence issues also involve ethics, send the request to the Designated Agency Ethics Official or Alternative Designated Agency Official at DCAA's General Counsel (DL). DL will obtain input from Policy on GAGAS independence issues and prepare a consolidated response to all questions that involve both GAGAS and ethics concerns.

## (7) Compliance Requirements

DCAA auditors are required to comply with the preceding policies and procedures. Failure to do so may result in disciplinary action as appropriate.

### **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 [DCAA Recruiters](#). 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 orientation provided through the onboarding process conducted by DCAI, 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 [DCAA Instruction No. 1400.27](#), Probationary and Trial Period Policy.

#### 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 [DCAA Instruction No. 1400.15](#), Position Management and Position Classification Policy. 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 in 2-S102.2).

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 advisory 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, and universities and not-for-profits.

(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 DCAAI 1400.22, Auditor Rotation Policy.

#### 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 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 of the PMM and [DCAAI 1400.48](#), Performance Management Program.

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.

(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, , and Appendix B, of the manual and [DCAAI 1400.48](#), Performance Management Program.

(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 DCAAI 1400.48.

(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 GS-13 and above are made in accordance with DCAA's Career Management Program policies (see below). Positions GS-12 and below are promoted 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 [DCAAI 1400.38](#), Merit Promotion and Placement.

(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 GS-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 and ensuring auditors are independent,
- 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 independence and 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,
- nature of the audit services to be performed, and
- 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 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.

(2) Performance of Field Work. Every auditor assumes the duty to exercise professional judgment in the performance of 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 section 2-303.3 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 ensure 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, appropriate and relevant evidence to support a reasonable basis for his/her conclusions. Section [4-400](#), Section 4-Audit Working Papers 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. [Chapter 10](#), Preparation and Distribution of Audit Reports 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 Instruction 5600.1](#), Delegation of Signature Authority for Audit Reports and Other Related Documents. This Instruction also establishes the requirements for delegating supervisors' authority for signing certain audit reports and related audit documents.

#### c. Specialist Assistance

The auditor is responsible for obtaining sufficient appropriate evidence to express an opinion and support audit findings. Since the advice of specialists can constitute a significant part of this evidence, auditors must recognize when areas of an assignment require assistance from an individual possessing expertise in a field other than auditing or accounting, and then obtain assistance from individuals who have the skills needed to evaluate those areas. [Appendix B](#), Specialist Assistance contains detailed guidance on assessing the need for specialist assistance, requesting assistance from internal and external specialists, evaluating the work of the specialists, and referencing the specialist's work in the audit report.

### **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 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 line and staff managers and supervisors at all levels of DCAA. As stated above, Resources 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, Resources 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/Corporate Audit Director and Director, Field Detachment 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 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. 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, such as the peer review performed by independent reviewers as required by GAGAS.

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

in 2-S102.2).

(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, Headquarters Policy and Plans Directorate makes necessary updates to the Agency's Contract Audit Manual and 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, and 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 2-S103.2 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 by performing:

- QA-related review projects on both an Agency-wide and regional basis, and
- continuous rounds of internal reviews that follow guidelines adapted from the Council of the Inspectors General on Integrity and Efficiency (CIGIE) Review Guides.

The objectives of the CIGIE-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.
- 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.

Tools available to DCAA management to monitor working paper compliance with GAGAS and Agency policy are the DCAA-adapted CIGIE-based checklists for Quality Assurance Reviews of Individual Attestation Assignments and Cancellation Checklist. The checklists can be used for the purposes of auditor self-assessment, a peer review, or a supervisory review of the audit working papers. The checklists are maintained by Headquarters – Quality, and can be found the DCAA Intranet Quality Assurance Directorate webpage under Quality Checklists.

#### **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 auditor 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, CADs, 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 (DoDD 5105.36), DCAA Instructions and Manuals. Most [Agency publications](#) are contained on the DCAA intranet and are accessible to all auditors. The majority of the quality control procedures are implemented in the CAM. The CAM is updated continuously and available to all personnel on the DCAA Intranet.

(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, DCAA regulations, instructions, personnel management manual, etc. The Agency also documents its system of

quality control for the Department of Defense, Office of Inspector General (DoDIG) through completion of Appendix A – Policies and Procedures, of the Inspectors General on Integrity & Efficiency (CIGIE) Guide for Conducting Peer Reviews of Audit Organizations of Federal Offices of Inspector General.

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](#), Managers' Internal Control Program 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), Resources 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
- 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 in 2-S102.2 above) and staff of program managers, and through the general management and oversight of DCAA's Quality Assurance (QA) function.