

MASTER AUDIT PROGRAM

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| Activity Code 11090 | Business System Deficiency Report Assignment |
| Planning Considerations | Version 3.1, dated Feb 2025 |

Audit Specific Independence Determination

Members of the audit team and internal specialists consulting on this audit must complete the Audit Specific Independence Determination (WP 34) prior to starting any work on this assignment.

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

Purpose and Scope

This assignment is intended to be used in two circumstances:

- To prepare and issue an audit report on deficiencies/instances of noncompliance with the DFARS criteria in a contractor business system after they are identified in an audit other than a business system audit (e.g., incurred cost, price proposal, or any other type of audit). In this case, the effort under this assignment may also include the performance of additional procedures to evaluate the deficiencies/noncompliances and to fully develop the elements of a finding (see CAM 10-409) if that was not fully accomplished in the originating assignment. However, such effort should generally not be extensive since the objective is not to evaluate the contractor's compliance with all aspects of the applicable DFARS criteria but only to establish whether the noncompliance identified in the originating audit represents a material weakness in compliance with DFARS or system deficiency in compliance with DFARS criteria to report to responsible contractor management officials.
- To prepare and issue an audit report on a material weakness in compliance with DFARS criteria in a contractor business system after it is identified, and its existence is fully supported as part of an in-process business system audit.

In either case, the deficiency report is an integral part of the originating GAGAS examination engagement, and this deficiency report assignment does not represent a separate examination engagement.

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Purpose and Scope

Definition of Material Weakness

DFARS 252.242-7005, *Contractor Business Systems* defines *Material weakness* as, “a deficiency or combination of deficiencies in the internal control over information in contractor business systems, such that there is a reasonable possibility that a material misstatement of such information will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is—

- (1) Probable; or
- (2) More than remote but less than likely (section 806 of Pub. L. 116-283).”

Reporting Deficiencies Identified During Audits Other Than Business System Audits

In accordance with GAGAS, auditors are required to report certain findings identified during an attestation examination engagement even when those findings are related to areas outside the specific objectives of the examination and the findings are based on the engagement work performed (GAGAS 7.42 and 7.44). Those findings include, among other things, all material weaknesses and system deficiencies in internal control, material instances of fraud, and material noncompliance with provisions of regulations or contracts that have an effect on the subject matter of the examination engagement. Less than material noncompliances that warrant the attention of those charged with governance (the contractor and contracting officer) should be communicated in writing to those charged with governance (the contractor and contracting officer) (GAGAS 7.45). Professional judgement will be used in determining how to communicate noncompliances that do not warrant the attention of those charged with governance (the contractor and contracting officer) (GAGAS 7.46). The requirements for reporting include deficiencies in a contractor’s business system, which generally result in noncompliance with the DFARS business systems criteria. identified during performance of incurred cost, price proposals, or any other nonbusiness system audits. To facilitate tracking and timely resolution of such deficiencies and noncompliances, DCAA reports material weaknesses and system deficiencies with the DFARS business systems criteria identified in audits other than business system audits in a separate report rather than in the report on the originating examination engagement where the conditions were identified.

Reporting Material Weaknesses Identified During **In-Process** Business System Audits

Because of the importance of timely communication of material weaknesses in compliance with DFARS criteria, in some cases, it may be appropriate to issue a deficiency report on a real-time basis prior to completion of the business systems audit once there is sufficient evidence supporting that a material weakness exists and the elements of findings are fully developed as a part of the originating business system audit. Whether to issue a separate deficiency report prior to completion of the business system audit using this deficiency report assignment is a matter of professional judgment, depending on the specific circumstances.

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| Purpose and Scope |
| <p>The deficiency report is an integral part of the originating examination engagement and this deficiency report assignment does not represent a separate examination engagement. It is not necessary to perform and document many of the procedures generally required to comply with GAGAS for an examination as a part of this assignment, since the procedures would be documented in the originating examination engagement. This assignment should reference the originating assignment and include the working papers from that assignment that support the finding for the deficiencies and noncompliances. In the case of deficiencies and noncompliances identified in other than business system audits, this assignment may also include additional procedures to evaluate the deficiencies and noncompliances and to fully develop the elements of a finding.</p> |
| <p>The program steps are intended as general guidance and should be tailored as determined necessary. The audit steps in the program should reflect a documented understanding between the auditor and supervisor as to the scope required to comply with GAGAS in an efficient and effective manner to meet the assignment objectives.</p> |

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| B-1 Preliminary Steps | WP Reference |
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| Because this is not a separate examination engagement, generally only the following preliminary procedures are required, which do not constitute a full risk assessment. | |
| 1. Document the auditor's discussion with the contracting officer regarding the deficiency in accordance with CAM 4-105. | |
| 2. Review the working papers of the audit assignment that disclosed the deficiency and noncompliance with the DFARS business system criteria. | |
| a. For deficiencies identified during in-process business system audits, verify that sufficient appropriate evidence was obtained to support that a material weakness exists, and that the elements of a finding were fully developed as a part of the originating business system audit. Do not proceed until that has been accomplished. | |
| b. For deficiencies identified in audits other than business system audits, if evaluation of the deficiency and the elements of a finding were not fully developed in the originating assignment, tailor this audit program to include the necessary additional procedures. The additional procedures should include steps to determine if the deficiency and noncompliance is a material weakness in compliance with the DFARS criteria, or is a system deficiency. The goal is to have responsible contractor management take appropriate corrective action. The elements of a finding should be developed for both material weaknesses in compliance with the DFARS criteria and those noncompliances determined to be system deficiencies. Auditors should consider incorporating relevant steps from the applicable business systems audit program; i.e., those covering the DFARS criterion to which the deficiency relates and that are required to evaluate and fully develop the particular deficiency. (This will not necessarily be all procedures for a specific criterion.) | |

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| C-1 Development of the Material Weakness | WP Reference |
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| Version 3.1, dated Feb 2025 | |
| 1. Reference the originating audit assignment and incorporate working papers from that assignment that support the finding of deficiency and noncompliance with DFARS criteria. | |
| 2. Perform any additional procedures necessary based on the preliminary procedures in B-01, step 2, to evaluate the deficiency and fully develop the elements of a finding. | |
| 3. Determine and document the reliability of the information the audit team will use to reach their conclusions in this section. | |

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| A-1 Concluding Steps | WP Reference |
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| <p>1. Summarize the results, prepare the draft report including the statement of conditions and recommendations, if applicable, in accordance with CAM Chapter 10. Reports on deficiencies identified in other than business system audits may include material weaknesses in compliance with the DFARS criteria and system deficiencies.</p> <p>Reports on deficiencies identified in in-process business system audits will only include noncompliances with DFARS criteria that are either material weaknesses and/or system deficiencies.</p> | |
| <p>2. When auditors identify both a material weakness in compliance with the DFARS criteria and a system deficiency, the auditor will include the material weaknesses in the audit report in an Exhibit titled “Material Weaknesses.” All additional system deficiencies in compliance with DFARS criteria that are material in nature will be included in a separate Exhibit titled “System Deficiencies.”</p> | |
| <p>3. If no reportable deficiencies are noted, a Memorandum for Record may be issued to close the assignment.</p> | |
| <p>4. Auditors should communicate with the contracting officers upon the completion of the audit and document the communication in the working papers.</p> | |
| <p>5. After obtaining DCAA management approval, hold and document an exit conference in accordance with CAM 4-304. Obtain the contractor’s reaction regarding all deficiencies included in the report.</p> | |
| <p>6. Finalize the audit report or memorandum incorporating the contractor’s reaction and auditor’s response to the contractor’s reaction.</p> | |
| <p>7. Update the permanent file in accordance with CAM 4-405b.</p> | |
| <p>8. Brief the FAO on findings and any effect on FAO future audits.</p> | |