



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD-730.5.35

July 18, 2013
13-PPD-012(R)

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

SUBJECT: Audit Alert — Alternate Procedures for Labor When Real-Time Testing of Labor not Performed (MAAR 6)

While in most cases subsequent year incurred cost audit procedures cannot entirely substitute for the missed opportunity to conduct a physical observation/interview of an employee, the audit team should make every effort to apply alternate procedures to test employee existence and allocability as part of their post year-end audit procedures. The purpose of testing labor as it is incurred (real-time) is to ensure employees are actually at work, that they are performing in their assigned job classification, and their time is charged to the proper cost objective.

Alternate procedures to test for **existence** may include:

- For employees still employed, physically observe employee and inquire as to start date with contractor to ensure the employee worked for the contractor in the year under audit.
- For employees no longer employed, review employee personnel records (e.g., copies of driver license, passport, contractor badge, etc).
- Validate payment of sampled employees to contractor bank statement, electronic funds transfer, or third party payroll processor records.
- Review other documents the employee may have created, processed, or approved during the period under audit (e.g., travel records/employee expense reports, W-4s, leave requests).
- Determine if Contracting Officer has other evidence corroborating employee existence.

Alternate procedures to test for **allocability** may include:

- Review contract requirements (i.e., key employee, job title, or labor category).
- Review statement of work and work orders/authorizations to ensure labor type (i.e., scientist) is required to perform the work.
- Determine if Contracting Officer has other evidence corroborating employee's labor is allocable to the contract.

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For both existence and allocability, the audit team must use judgment to determine if the combination of evidence gathered is sufficient and appropriate. For example, an examination may result in evidence of current employment of some of the sampled employees, validation of personnel records for other sampled employees, and contracting officer records for other sampled employees. The audit team should consider the combination of the evidence gathered when determining the sufficiency of evidence based on the audit risk.

Impact on Planning

If the audit team determines that labor is a significant element and they are unable to develop alternate procedures to test for employee existence and allocability, the audit team should change the scope of the engagement by documenting there are no reasonable alternate procedures that can be performed. The audit report will also need to be modified to address only the cost elements/accounts examined in the subject, and results of audit sections and report exhibits (e.g., direct material, non-labor expense accounts, etc.). Refer to Enclosure 2 for additional guidance on modifying report sections.

Impact on Audit Opinion

In determining the overall opinion, auditors should consider such things as audit risk, significance of claimed labor costs, and contract mix. In most cases, when we have not performed real-time testing of labor, the audit team should issue a qualified opinion, even when performing alternate procedures. If the alternate procedures do not provide sufficient appropriate evidential matter, the audit team may not be able to opine on the labor cost element resulting in a qualified or overall disclaimed opinion.

If the audit team determines that they have to disclaim an opinion, they should report significant noncompliances that can be supported by sufficient appropriate audit evidence in the appendix (i.e., Other Matters to be Reported).

Further Assistance

Field audit office personnel should direct questions regarding this memorandum to their regional points of contact. Regional personnel with questions should contact Policy Program Division, at (703) 767-2270.

/s/

Donald J. McKenzie
Assistant Director
Policy and Plans

Enclosures: Frequently Asked Questions

a/s

DISTRIBUTION: E

Frequently Asked Questions

Question 1: While planning an incurred cost audit, the audit team determined that the FAO did not perform the MAAR 6 engagement for the year under audit and labor is a significant cost element. Do I have to disclaim an opinion?

Answer: In most cases, No. The audit team should first perform alternate procedures on labor and determine if they provide sufficient appropriate evidence to form an opinion. In most cases, the alternate procedures will provide the audit team with sufficient information to at least provide a qualified opinion on labor.

Question 2: While planning an incurred cost audit, the audit team determined that the FAO did not perform the MAAR 6 engagement for the year under audit and alternate procedures could not be performed (e.g., missing timesheets and payroll records). Do I have to disclaim an opinion?

Answer: No. Because the audit team was in the planning stage of the audit (e.g., during the walkthroughs) when it was determined they could not perform sufficient procedures to opine on labor, the audit team can discuss with the contracting officer modifying the scope of audit to provide the most value and opine on specific elements (e.g., direct material, non-labor expense accounts, etc.).

Question 3: After completing the fieldwork related to the alternate procedures, can the audit team adjust the scope of audit to remove labor if the alternate procedures do not provide sufficient appropriate evidence?

Answer: No, once the audit team has applied the alternate procedures and collected evidence the scope of audit should not be changed. However, if the audit team's understanding of the contractor is not correct and the planned alternate procedures cannot be performed the audit team should adjust the planning and may consider removing labor from the scope of audit.

Question 4: When reporting on specific elements of cost, should auditors include in the Results of Audit section a statement that the report disclaims an opinion on the contractor's submission as a whole?

Answer: No, the report opinion applies to the elements (e.g., direct material, non-labor expense accounts, etc.) described in the Subject of Audit and Results of Audit sections; therefore, the audit team is not disclaiming an opinion on the contractor's submission as a whole.

Question 5: If we change the scope of the engagement by modifying the subject and results of audit to exclude labor and labor is a significant element, can the audit team opine on indirect rates?

Answer: No, the audit team cannot opine on indirect rates. When a significant element of the base or pool is no longer part of the scope of audit the report should not include the rates. However, the audit team may opine on the non-labor indirect expenses. Once the report is issued

the audit team can provide assistance to the ACO in calculating the rates based on the negotiation position taken by the ACO.

Question 6: If we change the scope of engagement by modifying the subject and results of audit to exclude labor, should we include a scope limitation and/or disclaimer of opinion on the labor cost element in the results of audit section?

Answer: No, since labor is no longer part of the scope of audit, a scope limitation or disclaimer of opinion on labor would not be warranted.

Question 7: Can the audit report include a Cumulative Allowable Cost Worksheet (CACW) when reporting on specific elements of costs?

Answer: No, audit reports on specific elements of costs should **not** include CACWs. To do so could mislead the contracting officer into believing all of the contract costs have been audited. Once the report is issued and the ACO has established the final rates and direct costs the audit team can provide assistance to the ACO in developing a CACW.

Question 8: When reporting on specific elements of costs, can the audit team provide penalty recommendations on expressly unallowable costs?

Answer: Yes, when the audit team can substantiate material noncompliances with sufficient appropriate evidence they should provide penalty recommendations on expressly unallowable costs.

Question 9: After issuing an audit report on specific elements, can the audit team assist the contracting officer with assessing the report's impact on negotiations?

Answer: Yes, FAOs should provide negotiation support to ACOs to assist them in their understanding of the report's impact.

Example Incurred Cost Report on Non-Labor Portions of Contractor's Proposal. However, the example language can be modified for a specific cost elements reviewed.

SUBJECT OF AUDIT

We examined the non-labor portion of [Contractor Name 1st Line] ([Contractor Acronym]) [Date of Submission] [*type of proposal*] proposal and related books and records for reimbursement of FY [Year (4 digit)] [Year (4 digit)] incurred costs. The purpose of the examination was to determine allowability of [*direct cost elements examined and indirect expenses*]. A copy of [Contractor Acronym]'s Certificate of Final Indirect Costs, dated [*date of certificate*], is included as Appendix [x] to the report (see page [x]).

The proposal is the responsibility of the contractor. Our responsibility is to express an opinion based on our examination.

EXECUTIVE SUMMARY

[This section gives a brief overview of the audit findings. It briefly describes the audit opinion, recommendations, and the significant issues supporting the opinion. This section can be omitted in reports where the Results of Audit sufficiently summarize the audit findings. An example of the Executive Summary is shown in CAM Figure 10-2-2.]

SCOPE OF AUDIT

[Use the standard scope of audit paragraph]

QUALIFICATIONS

[Note – The audit is related to the non-labor portion of the contractor's proposal therefore, there is no scope limitation in regards to labor.]

[Identify any circumstances encountered that have a significant adverse effect on the audit or results. (See 10-210.4.) If the audit involves requests for assist audits on subcontract or intracompany costs, include a paragraph similar to the following and refer to 10-504.4 for additional detail on required information.]

We have requested assist audits of subcontract costs included in the contractor's incurred cost submission, as identified above. Upon completion of the related prime contracts, and prior to submission of our final audit report or cumulative allowable cost worksheets on these prime contracts, we will reconcile the subcontract costs claimed by the prime contractor to the cumulative allowable costs and fee/profit included in the final cumulative allowable cost

worksheet or contract audit closing statement. These assist audit results do not impact the indirect expense rates of the prime contractor for this Fiscal Year. Any subcontract costs questioned in the assist audit will be reflected in future adjustment vouchers submitted by the subcontractor following settlement of the subcontractor rates. Therefore, the results of our evaluation are qualified to the extent that the issuance of this report does not indicate final acceptance of the claimed subcontract costs.

RESULTS OF AUDIT

[Detail the major findings of the indirect and direct cost audit in this paragraph.]

Indirect Expenses

[Indirect expenses accepted as proposed.]

In our opinion, [except for the *(describe the qualification and the potential impact on the results)*], the contractor's non-labor indirect expenses are acceptable as proposed.

[The auditor's indirect expense adjustments were accepted by the contractor.]

In our opinion, [except for the *(describe the qualification and the potential impact on the results)*], the contractor's proposed non-labor indirect expenses are acceptable as adjusted by our examination. The examination results and recommendations are presented below.

[The auditor's indirect expense adjustments were not accepted by the contractor.]

In our opinion, the contractor's proposed non-labor indirect expenses are not acceptable as proposed. The examination results and recommendations are presented below.

The contractor did not accept our findings and recommendations with respect to [*state major areas of disagreement*]. [*You may need to include the following sentence:*] The amounts disapproved are set out in the attached DCAA Form(s) 1.

Direct Costs

[No direct costs questioned.]

In our opinion, [except for the *(describe the qualification and the potential impact on the results)*], claimed non-labor direct costs are acceptable and are provisionally approved, pending final acceptance. Final acceptance of amounts proposed under Government contracts does not take place until performance under the contract is completed and accepted by the cognizant authorities and the audit responsibilities have been completed.

[Direct costs questioned.]

In our opinion, [except for the *(describe the qualification and the potential impact on the results)*], the contractor's claimed non-labor direct costs are acceptable as adjusted by our examination. We questioned \$ __ of direct costs proposed under Government contracts. *[Briefly describe the reasons for the major cost exceptions.]* Questioned direct costs by element within specific contracts are presented in Exhibit __, page __. Non-labor direct costs not questioned are provisionally approved pending final acceptance. Final acceptance of amounts proposed under Government contracts does not take place until performance under the contract is completed and accepted by the cognizant authorities and the audit responsibilities have been completed.

[Note –The audit is related to the non-labor portion of the contractor's proposal therefore, there is no disclaimer of opinion needed in regards to labor.]

Indirect Costs Subject to Penalty

[Use the standard penalty paragraphs, as applicable]

[Paragraph on CACWS removed from the report]

[Refer to 10-504.5 for additional detail and examples of the following areas:

- *Exhibits and Schedules. The Results of Audit section of the report should contain all exhibits and supporting schedules required for a clear, complete presentation of the audit results, including non-labor direct costs and non-labor indirect expenses. The specific procedures for achieving this reporting standard are noted in 10-504.5e.*
- *Additional Remarks. Some of the topics noted in this area are:*
 - *DCAA Form 1 [if applicable]*
 - *Certificate of Final Indirect Costs*
 - *Penalties]*

[Exit Conference]

[Use the standard exit conference paragraph]