



DEFENSE CONTRACT AUDIT AGENCY
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IN REPLY REFER TO

PAS 730.3.B.2.4

June 15, 2021
21-PAS-004(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
CORPORATE AUDIT DIRECTORS, DCAA
ASSISTANT DIRECTORS, HQ, DCAA

SUBJECT: Audit Alert on Reporting Material Noncompliances and Scope Limitations

The purpose of this MRD is to remind audit teams of their responsibilities in reporting material noncompliances and scope limitations. A listing of Frequently Asked Questions (FAQs) is included as the Enclosure.

Reporting Material Noncompliances

Auditing standards require auditors to formally report any material noncompliances. A noncompliance exists when an examination discloses that the assertion is not in conformity with the criteria (e.g., FAR, CAS, DFARS, contract terms, etc.). Examples of material noncompliances encountered in a DCAA audit could include the following: forward pricing labor rates based on unreasonably high escalation factors (a noncompliance with FAR), incurred cost claims for overtime premiums on a contract that does not allow for overtime premiums (a noncompliance with contract terms), or a significant deficiency related to the DFARS Business System Criteria (a noncompliance with DFARS).

Unless disclaiming an opinion, material noncompliances should be reported under the subheading "Material Noncompliances" in the "Basis of [Type of Modified Opinion] Opinion" paragraph. This is where we briefly describe the material noncompliance(s) and refer the reader to the detailed discussion in the exhibit notes.

Reporting Scope Limitations

Scope limitations occur when the audit team is unable to obtain sufficient appropriate evidence (i.e., unable to apply all the procedures considered necessary in the circumstances). Examples of scope limitations encountered in a DCAA audit could include the following: failure to receive agreed-upon assist audits, lack of real-time testing procedures (e.g., MAAR 6 or MAAR 13) on significant cost elements, or an inability to review important source documents.

When reporting a scope limitation, the auditing standards require us to describe in the report the effect (or potential effect) of the scope limitation and its significance to the subject matter. Scope limitations should be reported under the subheading "Scope Limitations" in the "Basis of [Type of Modified Opinion] Opinion" paragraph.

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Questions and Further Information

For further guidance and information, see CAM 10-208.

FAO personnel with questions regarding this audit alert should contact their regional or CAD offices. Regional/CAD personnel with questions regarding this audit alert should contact John “Sean” Glennon, Program Manager at 571-448-6404 or PAS at DCAA-PAS@dcaa.mil.

/Signed/

Martha E. McKune

Assistant Director, Policy and Quality

Enclosure:

Frequently Asked Questions

DISTRIBUTION: E

FREQUENTLY ASKED QUESTIONS

Question 1: How do we determine if a noncompliance is material?

Answer: Per CAM 2-303.6a, noncompliances are material if “individually or in the aggregate, they could reasonably be expected to influence relevant decisions of intended users that are made based on the audited information.” For DCAA, the intended users are generally contracting officers. Materiality has a quantitative component (a purely mathematical consideration of the volume of dollars) and a qualitative component (any other consideration that would influence a contracting officer’s decision.) A quantitatively immaterial amount may be qualitatively material if it relates to indicators of fraud, sensitive accounts, or cost elements where a contracting officer expressed particular concern. It is also important to consider noncompliances in the aggregate. For example, questioned costs on one G&A account may be immaterial, but when combined with questioned costs on other G&A accounts may result in material questioned G&A costs.

Question 2: How do we report material noncompliances when disclaiming an opinion?

Answer: In the rare instance when the audit team must issue a disclaimer of opinion, the audit report should describe the nature of any material noncompliance and its actual or potential effect on the subject matter in a “Report on Other Matters” appendix. See CAM 10-208.7b and c for guidance on reporting noncompliances when disclaiming an opinion.

Question 3: Do we report immaterial noncompliances?

Answer: GAGAS divides immaterial noncompliances into those that are “less than material but warrant the attention of those charged with governance” and those that “do not warrant the attention of those charged with governance.” For the latter, the auditor may use their own professional judgment to determine whether and how to communicate the noncompliance. When a noncompliance is less than material but does warrant the attention of those charged with governance, GAGAS 7.45 requires that the noncompliance be communicated “in writing.” The method used to make the written communication (e.g., memorandum, email, etc.) should follow any Region/CAD norms but is otherwise a matter of professional judgment.

Question 4: Should we report a scope limitation if we were able to perform alternate procedures?

Answer: An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate evidence by performing alternative procedures. For that reason, auditors should use professional judgment to determine if a scope limitation still exists when alternate procedures were performed. In some cases (e.g., an incurred cost audit where limited reviews of HR records were performed in the absence of a floor check), alternate procedures may only partially address the lack of evidence. In such cases, the audit team should include the scope limitation in the “Scope Limitations” section in the “Basis of [Type of Modified Opinion] Opinion” paragraph, describing the scope limitation but also describing the alternate procedures performed and the potential impact as mitigated by the alternate procedures. Whatever decision the audit team makes about whether to formally report a scope limitation, their judgment should be documented to ensure compliance with the auditing standards.

ENCLOSURE