



**DEFENSE CONTRACT AUDIT AGENCY
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IN REPLY REFER TO

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MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA
CORPORATE AUDIT DIRECTORS, DCAA
ASSISTANT DIRECTORS, DCAA

SUBJECT: Revised Audit Guidance for Contractor Business System Audits

What You Need to Know

Business System Terminology – DFARS Change

On January 17, 2025, the Defense Acquisition Regulation Council issued a final rule amending the Defense Federal Acquisition Regulation Supplement (DFARS) to implement section 806 of the National Defense Authorization Act for Fiscal Year 2021 that defines the term “material weakness” for Government evaluation of contractor business systems. This change replaces the term “significant deficiency” with “material weakness.”

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.”

Previously, the DFARS included a definition of “significant deficiency” in the context of DoD evaluation of contractor business systems. “Significant deficiency” was defined 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.*”

A material weakness based on the new DFARS definition will generally represent a significant deficiency as previously defined by DFARS. To evaluate if a deficiency or a combination of deficiencies results in a material weakness, the auditor should consider the materiality, pervasiveness and the following factors:

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- the nature and frequency of the noncompliance with the DFARS criteria identified,
- the root cause of the noncompliance,
- the effect of compensating controls, and
- the potential impact of the noncompliance if not corrected.

The definition of “material weakness” also aligns with generally accepted government auditing standards.

Other DCAA Business System Terminology

In addition to the DFARS change in terminology, DCAA is modifying and clarifying the terminology used to report noncompliances that do not rise to the level of a material weakness as outlined below.

- a. System deficiency: A deficiency or combination of deficiencies in the internal control over information in contractor business systems that does not rise to the level of a material weakness.
- b. Less than material noncompliance that warrants attention of those charged with governance: A noncompliance that does not have a material impact on the acceptability of the business system but is important enough to be communicated. The term “those charged with governance” includes both the contractor and contracting officer; therefore, less than material noncompliance that warrants attention of those charged with governance should be communicated in writing to both the contractor and contracting officer.

Business System Follow-up Audits

Follow-up business system audit programs were created for Accounting Systems, Post-Award Accounting Systems, Cost Estimating Systems, and Material Management and Accounting Systems (MMAS). The new follow-up audit programs will be identified as sub-activities under the existing business system activity codes. The follow-up programs direct the audit team to prepare and design audit procedures necessary to examine the revised business system practices (corrective actions) related to the previously reported material weaknesses/system deficiencies.

Additional Accounting System Updates

In addition to the changes above, the 11070 accounting system audit program was also revised to move detailed audit procedures to the risk assessment section and remove the audit

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step to test executive compensation. If executive compensation is identified as an area of risk, the auditor can tailor the audit program as needed.

New Estimating System Audit Program

A new cost estimating system audit program was created to organize the audit program steps and field work section by DFARS criteria. The new audit program contains all the audit procedures included in the current estimating system audit program. Aligning the audit program with the DFARS estimating system requirements may lead to more efficient and effective audits. When initiating a new cost estimating system audit, the FAO may select either the new audit program (24010DC – organized by DFARS criteria) or the existing audit program (24010CE - organized by cost element).

What You Need to Do

Auditors currently performing business system audits are required to update the audit package to comply with the new terminology. If FAOs issued a business system report using the old terms, the FAO should discuss the report with the contracting officer and contractor and follow the guidance in CAM 10-213 as needed.

Additionally, if FAOs initiated a follow-up business system audit before the date of this memorandum, FAOs should follow CAM 5-111 and update the audit package as needed.

Questions and Further Information

To align with the DFARS change, all business system audit programs, report templates, and CAM Chapter 5 have been updated to reflect the revised terminology.

FAO personnel with questions regarding this memorandum should contact their regional or CAD offices. Regional/CAD personnel with questions regarding this memorandum should contact Policy Systems & Cost Accounting Standards (PSC) Division for assistance via e-mail at dcaa.belvoir.hq.mbx.dcaa-psc@mail.mil.

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