

## Chapter 4

### General Audit Requirements

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## **4-000 General Audit Requirements \*\***

### **4-001 Scope of Chapter \*\***

This chapter presents general guidance and basic auditing concepts and techniques to assist the auditor in accomplishing the objective of contract auditing. Amplification of this guidance will be found in later chapters and appendixes.

## **4-100 Section 1 - FAO Coordination with Procurement and Contract Administration Personnel \*\***

### **4-101 Introduction \*\***

This section presents guidance on general coordination with procurement and contract administration personnel.

### **4-102 Coordination with Contractor and Government Contract Administration Personnel \*\***

a. The maintenance of effective communications and interface with the people with whom DCAA is involved on a day-to-day basis is an important aspect of the audit function and is referenced in various sections of CAM.

b. Periodic visits are made to various field audit offices by DCAA regional personnel (RD, DRD, RAM) in conjunction with reviews of the adequacy and status of audits performed by such FAOs. Occasional visits are also made to FAOs by members of the DCAA Headquarters staff in connection with their assigned duties. In view of the

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importance of effective communication, regional and Headquarters personnel should, during visits to FAOs, make a reasonable attempt to arrange for meeting with appropriate contractor and Government contract administration officials. The primary purpose of such meetings is to provide contractor and Government representatives with an opportunity to express their views on relationships with DCAA and any significant developments or problems where DCAA may be involved or be able to provide assistance. In addition, it is expected that significant audit matters and problems requiring the cooperation or assistance of contractor or Government contract administration personnel would be discussed at these meetings. Discussions should be informal and conducted with an objective of mutual benefit.

c. In the case of visits to branch offices, it is contemplated that contacts would ordinarily be limited to contractor representatives at suboffices visited and Government contract administration offices in the same locality as the branch offices or suboffices visited.

d. Throughout each audit assignment maintain effective communication with Government contract administration personnel on significant matters, as necessary. Such communication alerts officials to matters needing immediate attention and allows them to take corrective action before the final report is completed. Document all discussions in the working papers, including date, participants' names and titles, and primary discussion points.

### **4-103 FAO Participation in Procurement Meetings Prior to Receipt of Audit Request \*\***

a. Prior to receiving an audit request, auditors may be invited by procurement representatives responsible for major procurements to attend meetings between the various stakeholders, e.g., the buying command, DCMA and the contractor. These meetings may occur early in the process, even before the contracting officer initiates a request for proposal (RFP). Auditors may participate in such meetings for the purpose of discussing general issues related to the procurement such as procurement schedule requirements, expectations on timely contractor support, and the identification of expected major subcontracts. In addition, auditors may provide general advice on what constitutes an adequate proposal and explain the [FAR 15.408](#) (Table 15-2) requirements for adequate certified cost or pricing data. Auditor participation in meetings held for these purposes does not impair auditor independence.

b. However, auditors are reminded that DCAA does not participate in meetings established to discuss proposal development, or review or provide input on draft proposals, which is a common practice for members of integrated product teams (IPTs). Regardless of the circumstances, auditors should always refrain from comments that could be construed as advising the contractor on how to develop its proposal. For example, auditors should not advise the contractor on specific methodologies for developing a cost element included in its proposal. However, auditors may advise the contractor that to be adequate, the proposal must include an explanation of the estimating process, including judgmental factors and the methods used in the estimate



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of that cost element.

c. Prior to accepting an invitation to such meetings, the FAO should discuss these ground rules for DCAA participation with the procurement representative. In addition, the auditor should discuss the ground rules at the start of the meeting so that other attendees are aware of the limitations for DCAA participation.

d. The FAO's participation in procurement meetings should be documented in a memorandum for record (MFR).

### **4-104 Establishing the Engagement/Acknowledgment/Notification Letter \*\***

a. Upon receipt of the audit request, the auditor should hold discussions with the requestor before beginning the audit to gain a clear understanding of the requestor's needs, to identify specific areas of concerns, and to discuss how DCAA can best meet those needs and address the requestor's concerns while complying with GAGAS. In some cases DCAA may be asked to perform an audit of only part(s) of a proposal rather than the entire proposal. The FAO should accept requests for audits of part(s) of a proposal. However, if the auditor is aware of risk factors that indicate additional part(s) or the entire proposal should be audited, the auditor should discuss those risks with the contracting officer and follow the procedures in 9-108.

b. The auditor should acknowledge the request in writing (via e-mail) within five days of receipt. If the risk assessment is not complete, the e-mail should document the conversation from paragraph a. and indicate we will furnish an acknowledgment letter once the risk assessment is complete and we have coordinated an agreed-to date with the requestor. Buying Commands have stressed that they want a realistic date upfront so they can plan the procurement and schedule the additional actions required before contract award. Therefore, in establishing an agreed-to date, the audit team should consider risk factors for the particular contractor and the engagement, and allow time for the necessary procedures and reviews. Other factors for consideration include: experience of the auditor, scheduled leave, and holidays. After considering these factors, the audit team should coordinate with the requestor to establish a mutually agreed-to date. Milestone plans can be a useful tool for the audit team to use in developing realistic due dates. Milestone plans are required for audits of all high risk proposals, major contractor incurred cost submissions, significant claims/terminations, and business system audits, but can be used as deemed necessary for other assignments as well. If the timeframe for completion identified by the audit team varies significantly from the needs of the requestor, the coordination of an agreed-to date may require involvement of regional management with the requestor and their chain of command.

Once the risk assessment is complete, the FAO should issue an acknowledgement letter which includes the agreed-to report date and details regarding the scope of the services to be provided and other information required by [GAGAS 6.07](#) (see CAM 2-303). The pro forma memo delivered by APPS (Acknowledgment – Notification to ACO.doc) meets the GAGAS requirements and should be used. That document is also

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available on the DCAA Intranet. For requested audits, the risk assessment should be completed as promptly as possible after receipt of the request and the walk-through of the proposal/submission by the contractor (see 4-302.1c).

c. After committing to an agreed-to date, everyone involved in the audit needs to make every effort to ensure that we provide the audit on or before the date. The auditor should provide the completed work paper package for review with sufficient time to allow for completion of the necessary reviews. Independent reference, supervisory and other management reviews also should be completed in a timely manner to ensure that we meet the agreed-to date.

d. If the proposal is inadequate but the requestor still wants an audit of that proposal, auditors should follow the guidance in 9-205d.

e. For audits that are not requested (e.g., incurred cost audits, postaward audits, and audits of contractor business systems), the auditor should contact the contracting officer to notify him/her of the audit commencement and discuss any concerns or other information that the contracting officer might have relevant to the audit. In addition, after the risk assessment is completed, a notification letter should be electronically transmitted to the planned recipient(s) of the audit report (using the pro forma memo Acknowledgment – Notification to ACO.doc which is delivered by APPS).

f. Requests for agreed-upon procedures should be acknowledged using the AUP pro forma memo (DCAA\_Acknowledgement\_Letter\_-\_Agreed\_Upon\_Procedures.doc) which is delivered by APPS and is also available on the DCAA Intranet. Before issuing the acknowledgement letter, follow the guidelines in 14-1002.3, Establishing an Agreement on the Terms of the Engagement.

g. Relevant discussions and meetings held during this phase of the audit should be documented in the working papers (e.g., discussions with the requestor/contracting officer regarding the clarification of the request and specific concerns).

### **4-105 Interim Discussions \*\***

a. Continuous communication throughout the audit keeps the requestor/contracting officer informed of major preliminary audit issues and problems. Prior to such discussions, the auditor should coordinate with the supervisor to ensure there is agreement on the audit position. Since the audit is not completed, the auditor should not provide an audit opinion during these interim discussions but should clearly communicate the status of the audit to the requestor.

b. As discussed in 4-104, the audit team will consider the risk assessment, the audit scope and the Contracting Officer's needs and coordinate an agreed-to due date for the engagement. If for any reason we are unable to meet an agreed-to due date, the auditor or supervisor should call the requestor as soon as he or she knows it will not be met, and request an extension and assistance in resolving contractor delays as necessary.

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c. Occasionally, before an audit is completed, the requestor may ask the FAO to cancel the audit or change the scope of the audit or type of engagement (e.g., to an agreed-upon-procedures engagement, examining parts of a proposal or providing specific cost information). In certain limited cases, this may be appropriate, for example, if there is a change in circumstances that affects the requestor's requirements or there was a misunderstanding about the nature of the original services or alternative services originally available. However, before an auditor agrees to a contracting officer's request to convert or cancel an engagement (e.g., agreed-upon procedure, examination, providing rate information or other nonaudit service), the FAO should consider the reason given for the request, especially if the audit procedures are substantially complete. Under no circumstances should DCAA agree to a contracting officer's request to cancel or convert an engagement to avoid a scope limitation, the reporting of an adverse or qualified audit opinion, or any other result that may be considered unfavorable. Generally, any changes that the requestor wants to make to their original request should be provided to the FAO in writing. The FAO should discuss the matter with the requestor to obtain a clear understanding of the reason for the request and explain any concerns regarding risk to the Government. The verbal discussion should generally be followed by written confirmation, either concerning the changes to the engagement that the FAO believes are appropriate or the reason why the change cannot be made. In addition, the matter should be elevated if necessary to resolve any differences.

d. All interim discussions with the contracting officer including coordination of a due date extension should be documented in the working papers. That documentation should include the date, participants' names and titles, and primary discussion points. As discussed above, some discussions should be confirmed in writing to the requestor/contracting officer.

### **4-106 Exit Conferences and Release of Draft Audit Reports \*\***

a. The auditor should invite the requestor/contracting officer to the exit conference, especially if there are major or complex audit issues. The information provided to the contractor at or in anticipation of the exit conference (i.e., draft report/results or, in the case of forecasted costs subject to negotiations, factual information) should be provided concurrently to the requestor/contracting officer. (See 4-304 for guidance on exit conferences.)

b. The FAO manager may approve the release of the draft audit report on a proposal to the contracting officer after the exit conference when it is anticipated that the final report will be issued shortly. Such release may be made before the FAO manager completes the final review; if the FAO manager believes it is appropriate based on his/her involvement with the audit, and/or the complexity of the audit and the experience of the audit team. This allows the contracting officer to start developing the negotiation position, pending the issuance of the final report. The draft report should be clearly marked draft and also include the following or a similar statement "Subject to change based on final management review until the final report is issued". This draft report can be issued in Microsoft Word password protected format.

#### **4-107 Post Issuance Support \*\***

After the audit report is issued, auditors should provide the contracting officer assistance as needed to understand the audit conclusions and rationale. Providing such assistance is a normal part of any audit and does not impair an auditor's independence. Such assistance may involve answering questions informally, attending or otherwise supporting negotiations or attending DCMA Boards of Review. Documentation of support of negotiations or Boards of Review should be prepared in accordance with CAM 15-404 and CAM 1-403.4, respectively, and filed in Livelink in the same folder with the official audit working paper files (see 4-407e(9)). Detailed guidance on supporting negotiations is at CAM 15-400 and on attending Boards of Review at CAM 1-403.4.

#### **4-108 Negotiation Memorandum and Findings on Appeals \*\***

a. FAR provides that the contracting officer shall forward to the cognizant DCAA auditor one copy of the negotiation agreement (e.g., price negotiation memorandum (PNM) ([FAR 15.406-3\(b\)](#))), Memorandum of Disposition of Post-award Audits ([FAR 15.407-1\(d\)](#)), and Final Determinations on Contractor Appeals to DCAA Forms 1. In order to be timely and fully responsive to the needs of DoD management in providing information on audits, negotiations, etc., all field audit offices will establish formal follow-up procedures to ensure that copies of these contracting officer advices are timely received and promptly reported in the status reports required by Headquarters. For a contract awarded under competitive negotiation procedures, a PNM may not be prepared, but the information required by [FAR 15.406-3\(a\)](#) should be reflected in the evaluation and selection document, to the extent applicable, and forwarded to the cognizant audit office that provided assistance.

b. If the negotiation agreement (e.g., PNM) provided for by [FAR 15.406-3\(b\)](#) is not received by the auditor within 90 days following issuance of the audit report, and negotiations are known or expected to be completed (for price proposals, questioned costs should exceed \$500,000 to warrant follow-up unless the pricing action has been selected for a defective pricing audit), the field audit office will request a copy of the document directly from the cognizant procurement or administration activity with a copy of the request to the FLA. If necessary, the field audit office should issue a second follow-up request, identified as such, within 90 days of the first follow-up request for the PNM. Upon receipt of the second follow-up request, the FLA will become responsible for all further follow-up until the contracting officer distributes the PNM. Where the FLA encounters a continuing problem with timely distribution of PNMs, and corrective action is not effected, the FLA should elevate the matter for resolution by the region with its counterparts in the acquisition or administration activity.

c. Those activities with FLAs are listed in the [FLA Locator](#) on the DCAA Intranet site.

d. Auditors at subcontractor locations also require similar information relating to prime contractor or higher tier subcontractor negotiations with subcontractors. This information is needed for postaward auditing, assessing performance, and reporting

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purposes. The auditor at the prime contractor or higher tier subcontractor location should ensure that maximum support is given to subcontract auditor requests. In the event a contractor refuses to release the information for use outside its organization, it will be necessary for the auditor at the prime contractor or higher tier subcontractor sites to review the subcontract file and report pertinent information to the subcontract auditor.

e. Follow-up is required for copies of Final Determination on Contractor Responses to DCAA Forms 1. CAM 6-908c states that the auditor must have received a copy before a resubmission voucher can be processed.

### **4-200 Section 2 - Contractor Internal and External Audits \*\***

#### **4-201 Introduction \*\***

This section provides direction for requesting, using, and monitoring access to contractor internal and external audits.

#### **4-202 Access to Contractor Internal and External Audits \*\***

a. The auditor's evaluation of a contractor's internal controls, pursuant to CAM 5-100, may disclose, particularly at a major defense contractor location, that a contractor maintains a highly professional internal audit staff. In addition, the majority of larger contractors also engage an external public accounting firm to conduct an audit of their financial statements. While these internal and external auditors' final audit objectives are not the same as DCAA's, the information contained in their reports may be useful to DCAA in the course of our audits. The audit team, as part of the risk assessment, should ask contractor management if any internal audits were performed and request a summary listing of the internal audits that would assist in understanding and evaluating the efficacy of the internal controls relevant to the subject matter of the audit. If relevant internal audits are identified the auditor should follow the guidance in section c through f below when requesting internal audit reports.

b. SEC registered public companies are subject to additional certification and reporting requirements as a result of the [Sarbanes-Oxley Act of 2002](#). These companies are required to certify to the financial and other information contained in the quarterly and annual reports filed with the SEC, and are to include with their annual filing, a report of management on the company's internal control over financial reporting. They are also required to include with the annual report the independent auditor's attestation report on management's assessment of the company's internal control over financial reporting. As a result, public companies and their independent auditors may now perform additional audit effort to support the certification and reporting requirements. Auditors should be aware of the potential for increased opportunities in reviewing these audits as part of their audit risk assessment.

c. The [2013 National Defense Authorization Act \(NDAA\)](#) states that DCAA can use the internal audit reports for evaluating and testing the efficacy of contractor internal controls and the reliability of associated contractor business systems. The law not only

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allows the use of internal audits to assess the contractor's business systems; it also allows the use of internal audits to understand the efficiency of the contractor's internal control which we do as part of our risk assessment in every audit. Internal audit reports should not be used for other purposes. Requests for internal audit reports will only occur when the auditor/supervisor can demonstrate how the report may support the risk assessment or audit procedures in a current, on-going audit (i.e., there must be a nexus to your current audit effort).

d. The NDAA requires DCAA maintain appropriate documentation of requests for access to defense contractor internal audit reports. At a minimum, it requires DCAA maintain the following:

(1) Written determination that access to such reports is necessary to complete required evaluations of contractor business systems.

(2) A copy of any request from the Defense Contract Audit Agency to a contractor for access to such reports.

(3) A record of response received from the contractor, including the contractor's rationale or justification if access to requested reports was not granted.

e. The NDAA also requires DCAA include appropriate safeguards and protections to ensure that we do not use the contractor internal audit reports for any purpose other than understanding, evaluating, and testing the efficacy of contractor internal controls and the reliability of associated contractor business systems. DCAA should handle internal audits obtained from contractors in accordance with the procedures outlined in CAM 1-507, Security Requirements for Contractor Information, as well as the additional safeguarding requirements below.

f. In order to meet the requirements of the 2013 NDAA, the following reporting requirements and safeguards over contractor internal audits are established.

(1) Contract Audit Coordinator (CAC) and Major Contractor Offices. CAC offices and FAOs at major contractor locations will establish a central point of contact (POC) and a process to obtain and monitor access to and use of internal audit reports. If a segment of a CAC has its own internal audit department, the local FAO responsible for that segment should designate its own POC. The segment POC should coordinate with the overall CAC POC to ensure no duplication of effort. The segment POC must also support any segments reporting to their segment. The semi-annual report for each CAC location should include all documentation related to that CAC; therefore, POC's at segment locations must be sure to provide the documentation necessary to the CAC POC prior to the end of the reporting period (see g below). The process to obtain and monitor access to and use of internal audit reports will include a method for tracking requests for internal audit reports and working papers, when needed, and the contractor's disposition of these requests. The central point of contact will:

(a) Coordinate with the contractor and obtain a semi-annual summary level listing of all internal audit reports issued. The summary document should contain

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sufficient descriptions to ascertain whether the internal audit may affect Government contracts.

(b) Review the summary list of internal audits and use the list in discussions with the contractor to identify internal audits that are relevant to the subject matter of the DCAA audits. If the summary is not adequate to determine which internal audits may affect Government contracts, coordinate with the contractor to obtain the necessary information.

(c) Provide the summary list to the CAC Network or the FAO's audit teams responsible for audits of the contractor for use when inquiring about relevant internal audits during the audit entrance conference as part of the risk assessment.

(d) Send a request to the contractor for access to the internal audit reports and/or working papers considered pertinent for performing the audit and coordinate with the contractor to obtain access to the internal audit report (i.e. some contractors provide copies of the reports; others provide access to the report for the purpose of taking notes.). The request should describe the scope of the DCAA audit. It should explain why the internal audit would assist in: 1) understanding and evaluating the efficacy of the internal controls; and 2) assessing risk for the controls relevant to the audit. Additionally if the contractor provided a copy of the report to DCAA for a prior audit, the request should seek the contractor's agreement for the point of contact to provide access to the report for the current audit.

(e) Safeguard the internal audit report or notes taken on the content of the report (see CAM 1-507 for more information on handling contractor proprietary information).

(f) Implement a process to track auditor's requests for internal audit reports and the contractor's response to the requests.

(g) Provide the Region a semi-annual summary of all requests for internal audit reports. The summary should be grouped by contractor and include the contractor's response to each request, the audit assignment that required access to the internal audit report, and the usefulness of the internal report. If a CAC segment is tracking and monitoring at a local FAO, their semi-annual summary must be provided to the overall CAC POC to allow sufficient time for consolidation and submission to Headquarters by the due date discussed in f(2) below.

(2) Regional Offices. The Region will consolidate the POCs submissions by contractor. The consolidated Regional semi-annual reports are due to Headquarters on June 1st and December 1st (email to DCAA-PAS@dcaa.mil). The June 1st report should include information on requests still open from prior periods and new requests through April 30th. The December 1st report should include information on requests still open from prior periods and new requests through October 31st.

(3) Field Offices. The FAO audit team will:

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(a) Determine if access to the internal reports is necessary (a nexus is established) to complete the evaluation of the internal controls to support the risk assessment or audit procedures related to the subject matter of the audit.

(b) Coordinate with CAC or FAO point of contact to request access to pertinent reports. The request should include information on how the internal audit report is relevant to the DCAA audit.

(c) Review the internal audit reports and determine if sufficient information is contained in the report for use in identifying risk in audit assignments. In order for the internal audit report to be useful in audit planning, the auditor needs to understand the scope of the review, the reported deficiencies and any recommended corrective actions. If sufficient information is not included in the report, coordinate with the CAC or FAO point of contact to request access to the contractor's audit working papers for review.

(d) Summarize and reference the contractor internal audit reports in the working papers and discuss how the audit reports affected the audit plan. Do not include the contractor internal audit report in the working papers or the local perm files.

(e) Provide follow up information to the CAC or FAO point of contact regarding usefulness of internal audit reports for his or her use in updating the semi-annual summary of internal audits request report.

(4) For non-major contractors, a formal tracking process or a central point of contact is not mandatory. However, when requesting access to internal audit reports auditors should comply with the requirements of the 2013 NDAA discussed in paragraph d and the guidance in paragraph f(3)(a) through (d) above.

(5) When the contractor denies access to internal audit reports, the CAC or FAO manager will implement Access to Records procedures (CAM 1-504.5).

### **4-203 DCAA Response to Accounts Receivable Confirmation Requests from CPA Firms \*\***

a. Auditors occasionally receive requests from CPA firms to confirm the amounts represented by their clients as receivables due from the Government. These requests normally apply to contracts where provisional approval for interim payment of costs incurred to date is DCAA's responsibility. Confirmation of receivables is a generally accepted auditing procedure whereby the CPA seeks to verify the existence and accuracy of the dollar amounts reported as accounts receivable on the contractor's financial statement. Under Government contracting, it may be expected that the CPA will request positive rather than negative confirmation; in either case, it is DCAA policy to acknowledge each request.

b. Contractors usually establish a receivable under cost-reimbursement type contracts, in the amount of a public voucher, at the time it is submitted to the auditor. However, we cannot reasonably determine the exact timing of contractor payment by



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the disbursing office or the total amounts unpaid at any prior point in time. Furthermore, public vouchers represent claims for interim payments which are provisional in nature and subject to retroactive adjustments at any time prior to approval and payment by the Government of the contractor's completion voucher. Therefore, the auditor is not in a position to issue an unqualified confirmation of accounts receivable amounts, and could not issue a qualified confirmation of outstanding billings without the disbursing office coordination.

c. A confirmation request may also include contract billings which are not subject to audit approval, such as for progress payments, economic price adjustments, or deliveries under fixed-price type contracts. It is not appropriate for DCAA to expend any effort attempting to confirm such billings.

d. Because of the above considerations, auditors will not attempt to confirm amounts claimed by contractors as due from the Government. Tactfully and promptly acknowledge a CPA's confirmation request by letter, with a brief statement as to why we are not in a position to confirm a contractor's accounts receivable. Also provide, if available, the name and address of the Government disbursing office where additional information may be pursued if the firm so desires. For example, the acknowledgment might read:

*We acknowledge receipt of your confirmation request dated August 15, 20XX, concerning amounts represented by the XYZ Company as due from the Department of the Army as of July 31, 20XX.*

*Until completion of a cost-reimbursement type contract and later final settlement of the costs, we are not in a position to confirm that amounts claimed by a contractor are payable under the contract. Also, under any type of Government contract, we cannot determine the unpaid billed amount at any prior point in time because we do not maintain records of payments made. If you wish to pursue confirmation of the outstanding billed amounts, we suggest that you address your inquiry to the Army Finance Office, (address).*

### **4-300 Section 3 - Conferences with the Contractor (Entrance, Interim, and Exit) on Audit Plans and Results \*\***

#### **4-301 Introduction \*\***

a. This section provides guidance on audit conferences with the contractor. It states the basic requirements for and the extent and nature of discussions during entrance, interim, and exit conferences in general and under each type of audit assignment.

b. The [DCAA Management Information System \(DMIS\) User Guide](#) provides additional information on coordinating with contractors and contracting officers during the preparation of the requirements and future plans.

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c. Guidance on annual program plan conferences with contractors is contained in CAM 3-100.

d. Regarding contractor conferences in the mobile audit environment, see supplementary guidance as follows: (1) supervisory auditor participation (see CAM 2-302.2), (2) branch manager participation (see CAM 2-302.2).

e. Special guidance on preliminary conferences after a contract termination (before the contractor submits a settlement proposal) is in CAM 12-205.

f. Special guidance on preliminary conferences when performing concurrent incurred cost audits is contained in CAM 6-107.2.

g. Conduct all discussions with contractors with objectivity and tact in a forthright, professional manner.

### **4-302 Contractor Conferences – Entrance \*\***

#### **4-302.1 General Procedures for Entrance Conferences \*\***

a. Except as provided in 4-302.4, hold an entrance conference with the contractor's designated representative(s) at the start of each separate audit assignment (or each group of assignments to be covered in a single field visit). (See 4-302.1c regarding the “walk-through” of the contractor’s assertion that should generally take place either before or during the entrance conference.) Document the date, participants' names and titles, and primary discussion points, including specific identification of requested data to control what was requested and provided during the audit. The significance or sensitivity of the assignment will dictate the level and number of audit personnel who should attend the conference.

b. As a minimum, explain the purpose of the audit, the overall plan for its performance including the estimated duration, and generally the types of books, records, and operations data with which the auditor will be concerned. If applicable, the following matters should be handled during or shortly after the entrance conference:

(1) Make arrangements for any necessary work space and administrative support. Primarily, this applies to mobile assignments; however, auditors in a resident office or suboffice may also need temporary space in a particular operating location to effectively accomplish the audit.

(2) Ask the contractor to designate primary and alternate officials with whom audit matters are to be discussed during the course of the assignment. However, make it clear that such an arrangement does not preclude access to other knowledgeable contractor personnel as needed during the audit. Also make it clear that these arrangements should not cause delays or extra audit work (hence the advisability of having named alternate officials to expedite the audit should the primary official be unavailable). Complex, detailed, and time consuming procedures, such as requiring all data requests be written and/or funneled through a single individual only, are an

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obstruction to efficient audit operations. Contractor representatives' actions which unreasonably restrain, restrict, or delay the audit should be processed using the denial of access to records procedures set forth in CAM 1-504.3.

(3) Discuss, or obtain a briefing on, the contractor's proposal(s) or other cost representation(s) to clarify any preliminary questions, understand the basis of each submitted cost element, and learn the nature and location of supporting data. Follow-up on items discussed at a separate walk-through meeting if applicable (see 4-302.1c2 below).

(4) Visit all office and/or plant operating areas used in performing current and proposed contract(s).

(5) Arrange to review the planning documents, working papers, and audit reports of the contractor's internal and external auditors for any audits or reviews performed or planned that should be considered as part of the DCAA audit. See 4-202 for guidance on coordinated efforts with the contractor's auditors.

(6) Arrange for any needed IT audit assistance (see 4-500).

(7) When the assignment involves a subcontractor's cost representation(s), resolve any restrictions on release of audit findings and report information to higher-tier contractor(s) per CAM 9-106.4.

(8) Do not enter into written agreements with contractors, or affix concurrence signatures to contractor letters, which contain procedural arrangements that inhibit and/or delay the audit performance or restrict the reproduction of necessary supporting evidential matter.

c. At the commencement of the audit, the contractor should provide Government representatives (e.g., DCAA, ACO, and PCO) with a "walk-through" of its assertion (e.g., forward pricing proposal, incurred cost submission). The walk-through should generally take place after the auditor performs an initial adequacy review of the contractor's assertion and may occur either before or during the entrance conference. At these meetings, the contractor should fully explain its assertion and allow the audit team to ask questions to fully understand the contractor's assertion. This process will facilitate the early identification of any inadequacies with the contractor's assertion that need to be addressed. For example, where the request relates to a forward pricing proposal, the contractor should perform a walk-through of the proposal for the Government after proposal submittal and preliminary review by the Government. This provides an opportunity for all stakeholders to understand the composition of the proposal, identify any obvious data omissions, and may indicate whether the proposal contains inadequacies or if there are other issues that must be addressed before audit and/or negotiations (e.g., the contractor has not finished its price/cost analysis of subcontracts). Having the requestor participate in the walk-through will help to expedite the appropriate action if the proposal is not adequate or there are other issues that require the requestor's assistance. The auditor should document the walk-through

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meeting in the working papers.

### **4-302.2 Special Considerations for Entrance Conferences on Major Operations Audits \*\***

a. Hold a planning meeting with the contract administration office technical specialist(s) in advance of the joint entrance conference with the contractor, whenever technical assistance is being provided or a joint review/audit is being conducted. The technical specialist(s) should help develop the entrance conference agenda, such as identifying necessary data to be requested from the contractor. Also invite the specialist(s) to participate actively in the conference itself.

b. Notify the contractor's management several weeks before starting an operations audit or other system audit. This notice may be oral or in writing depending on resident working arrangements (4-302.4).

c. As applicable, mention the following matters during the initial contact before the entrance conference, and follow up during the entrance conference on each major system in addition to those matters common to all assignments (4-302.1).

(1) Request the cooperation of the contractor's top management and operating area management to expedite the audit.

(2) Give the contractor's management personnel an opportunity to explain how they have discharged their responsibilities to establish and maintain adequate internal accounting and administrative controls in the area being audited.

(3) Request the contractor to identify all reports and analyses used by any management level to evaluate and control the effectiveness, economy, and efficiency of the audit area.

(4) Request the contractor to provide an informational briefing on the organization and operations involved in the area to reduce the audit time. Such briefings may cover: organizational assignments affecting the area; system descriptions and/or flowcharts of transaction flows and system controls; and any identified problems and planned corrective actions or other planned changes in the area.

(5) Explain in advance the DCAA procedures for submitting draft statements of conditions and recommendations, and establish time frames for the contractor's written responses (see 4-304.5b).

### **4-302.3 Contractor Notification Letter \*\***

a. [GAGAS 6.5.04](#) requires auditors to communicate certain information regarding the audit, in writing to the contractor during the planning phase of the audit (see CAM 2-303). In order to fully comply with the GAGAS requirements auditors should provide the required information in a notification letter to the contractor using the pro forma letter delivered in APPS (W/P 11b – Contractor Notification Letter.doc). The letter is also available on the DCAA Intranet. The contractor notification letter will generally be

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addressed to the management official who signed the proposal or submission or who is responsible for overseeing the subject matter under audit when there is no proposal or submission. Because the letter provides an estimated report issuance date, generally it will need to be issued after completion of the risk assessment. The contractor notification letter does not replace the entrance conference.

b. The notification letter to the contractor on major system audits and other major audit assignments should also confirm the arrangements made and significant matters discussed at the entrance conference. Keep the letter's tone courteous and express appreciation for the arrangements made. However, make it clear that the arrangements should not in any way restrict access to records or personnel necessary to the audit performance. Predeterminations of all records, facilities, contractor personnel, etc. that may be needed before starting an audit are not possible.

### **4-302.4 Resident Working Arrangements for Entrance Conferences \*\***

a. Where auditors are assigned full time at the contractor site, it is usually desirable to establish local working arrangements for entrance conferences with the contractor. For example, some contractors may require that the auditor contact certain key personnel before starting specific types of audits (see 4-302.1b.(2)). The contractor may designate a permanent Government liaison representative for audits of a general nature, or the contractor's controller as the contact point for any financial system or compliance type audit and the chief of estimating as the principal contact for price proposal audits. A contractor might also desire a formal entrance conference only on major or nonrecurring audits while price proposal audits or other recurring audits are handled in a prearranged manner.

b. Working arrangements should be established only upon full mutual concurrence of the contractor and the FAO manager. They should not be permitted to restrict access to records or otherwise limit the audit scope. They should expedite the audit and not become so cumbersome as to cause delays or extra work.

c. Do not sign agreements for local working arrangements. If documentation is necessary, a confirming letter may be issued by the contractor, subject to cancellation or revision at any time upon the auditor's request. Make it clear that the auditor will bypass the arrangements anytime that they impede the audit. Additionally, do not enter into written agreements or affix concurrence signatures to contractor letters containing any access to records provisions. Understandings with contractors on reasonable conditions and procedures for the conduct of an audit shall not prejudice DCAA's access rights to perform audits and shall not be formalized in written agreements signed by DCAA representatives.

d. As a minimum, the FAO Manager will hold periodic conferences, usually more than one a year, with the appropriate level of contractor's representatives. Invite contracting officers as appropriate to attend these conferences. At such conferences, discuss any audit matters that need special management attention and advise the contractor of any significant changes in planned audit effort. Document such

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discussions.

### **4-303 Contractor Conferences – Interim \*\***

#### **4-303.1 General Procedures for Interim Conferences \*\***

a. Through-out the audit, the auditor should discuss matters with the contractor as necessary to obtain a full understanding of the basis for each item in the contractor's pricing data or other cost representation, or each aspect of the area subject to audit. Disclose to the contractor any factual duplications, omissions, or other mistakes noted in the contractor's assertion, records, or supporting data.

b. The auditor should discuss preliminary audit findings (e.g., potential system deficiencies, potential FAR/CAS noncompliances, etc.) with the contractor to ensure conclusions are based on a complete understanding of all pertinent facts. These types of discussions do not impair auditor independence and are generally necessary to obtain sufficient evidence to support audit conclusions.

(1) Discussions of the preliminary audit issues should be limited to factual matters when the audit is of forecasted costs that will be subject to negotiations. (See 4-304.2 below for a discussion of what constitutes factual matters.)

(2) In some circumstances, depending on the complexity of the issues and the auditor's experience level, it may be appropriate for the auditor to discuss the preliminary audit issues with the supervisor prior to the discussion with the contractor.

c. On occasion, the contractor may revise its submission during the course of the audit. Auditors must never request or suggest that the contractor revise its submission/proposal to correct or adjust for issues identified during an audit. However, in some cases the contractor may, of its own accord, make such revisions after the auditor has discussed preliminary issues with the contractor. In those cases, the audit report should reflect the results of the audit of the original submission and include all questioned cost and/or deficiencies identified during the audit. The requestor/contracting officer should be notified that the audit report will reflect the audit of the original submission, and will consider the contractor's management approved revised submission the contractor's concurrence with DCAA's audit position.

d. In the interest of equitable dealings with the contractor and in the proper discharge of official duties, apprise the contractor of any significant understatements noted in price proposals, reimbursement vouchers, or other cost representations when such understatements are clearly the result of obvious and unintentional oversight, bookkeeping or arithmetic errors, etc. Such cases may include mathematical errors in using improvement curve and other computational analysis techniques.

e. If apparent understatements of estimated costs in price proposals or related submissions do not meet the criteria stated above, do not discuss the auditor's conclusions with the contractor unless the negotiating contracting officer so requests. (See 4-304.2.)

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f. Handle errors on reimbursement vouchers as set forth in 6-1008e.

g. Document interim discussions in the working papers, including date, participants' names and titles, and primary discussion points. If warranted, the discussions should be confirmed in writing to the contractor, and if necessary, a copy should be sent to the ACO.

h. Communicate major audit problems encountered to contractor officials authorized to make a decision. Oral notification should be made at the earliest possible time, with written confirmation, and if necessary, a copy to the ACO. Do not wait until the final exit conference or the issuance of the audit report. Document any oral discussions with appropriate memorandums or notations in the working papers. Major audit problems include:

(1) Denial of access to records, including but not limited to:

(a) Unavailability of contractor personnel,

(b) Failure of contractor personnel to complete audit schedules on a timely basis,

(c) Unreasonable delays by management in permitting the commencement of the audit or in providing needed information.

Follow procedures in [DCAA Instruction 7640.17](#), Formal Reporting Procedures for Denial of Access to Contractor's Records, when denial of access is encountered.

(2) Items that impact the reliability of the contractor's books and records, including major internal control weaknesses,

(3) Significant differences concerning the application of generally accepted accounting principles,

(4) Conclusions regarding the reasonableness of estimates used in developing forward pricing/bidding rates,

(5) Any other items that may affect audit performance.

### **4-303.2 Incurred Cost Proposals – Interim Conferences \*\***

Promptly discuss significant system deficiencies found during performance of incurred cost audits with the contractor. Equally important is the timely written notification to the ACO of these deficiencies. Significant deficiencies are those with significant dollar impact on existing or future contracts or which require that the contractor take corrective action(s). Normally discuss the deficiencies during each system (material, labor, indirect expenses, etc.) audit. Oral discussions with the contractor should be followed up in writing to prevent any misunderstanding of the deficiencies found, and to solicit the contractor's plan of corrective action.

### **4-303.3 Operations Audits – Interim Conferences \*\***

a. During the audit, keep the contractor's designated representative informed of any problems encountered and interim results of completed phases. If necessary for the efficiency of the audit, a written follow up of the discussions should be sent to the contractor as soon as possible.

b. If contract administration personnel are assisting or participating in the audit, fully coordinate interim findings and recommendations with them before discussing deficiencies with the contractor. Joint reviews require especially close coordination to assure team members' consensus and complete understanding of the findings by the contract administration office. Also coordinate with contract administration technical personnel when the findings involve their area of expertise, but their assistance could not be provided during the audit. Discussions with the technical personnel in such cases can help clarify and/or support the findings when presented to the contractor.

### **4-304 Contractor Conferences – Exit \*\***

#### **4-304.1 General Procedures for Exit Conferences \*\***

a. Upon completion of the field work on each separate assignment, the auditor should hold an exit conference with the contractor's designated representative to discuss the audit results and obtain the contractor's views concerning the findings, conclusions, and recommendations for inclusion in the audit report as required by GAGAS. Except for audits requiring RAM review, the exit conference may be held after the supervisor completes his/her review of the working paper and draft report but before the FAO manager completes the final review if the FAO manager believes it is appropriate based on his/her involvement with the audit, and/or the complexity of the audit and the experience of the audit team. In such cases, the auditor should inform the contractor that the results are subject to management review and that the contractor will be advised if any significant changes are made. For audits requiring RAM review, all applicable management reviews must be completed prior to holding the exit conference.

b. The auditor should invite the requestor/contracting officer to the exit conference, especially if there are major or complex audit issues. The requestor/contracting officer may choose to invite additional participants who were involved with the audit or are interested in the results (technical personnel, price analyst, etc.).

c. Even when there are no questioned or unsupported costs, noncompliances, system deficiencies, or cost avoidance to be reported, the exit conference is a minimum courtesy to the contractor and is an important part of sound contractor relations. An exit conference may not be appropriate when the audit is performed in support of litigation (4-304.7), or investigations (4-702.5).

d. Confirm or follow up on requests for the contractor's reaction to any audit exceptions for inclusion in the audit report. See separate paragraphs as referenced for guidance on incurred costs (4-304.4), operations audits (4-304.5), and CAS adequacy



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and compliance audits (4-304.6).

e. For other than audits involving forecasted costs subject to negotiations, such as forward pricing audits, the auditor should provide the contractor a copy of the draft report, or at a minimum, the results of audit section of the draft report (including the opinion and any exhibits and notes, or statement of conditions and recommendations). To facilitate the discussion of the audit results and to obtain the contractor's views of the results, this information may be provided prior to the exit conference as long as the parameters regarding management review discussed in 4-304.1a have been met. If the report includes forecasted costs that are subject to negotiations, such as forward pricing audits, the auditor should not provide the contractor a copy of the draft report or results and should limit the discussion to factual matters/differences (see 4-304.2).

f. The information provided to the contractor at or in anticipation of the exit conference (i.e., draft report/results or, in the case of forecasted costs subject to negotiations, factual information) should be provided concurrently to the requestor/contracting officer. Prior to releasing the draft audit report and other electronic files they should be protected using Microsoft Word (i.e., be password protected to prevent modifications and clearly marked "For Official Use Only").

g. Document the exit conference in the working papers, including date, participants' names and titles, and specifically discussed items, and associated contractor's reaction, if any. The documentation should include copies of any draft reports or other information provided.

The auditor may obtain written documentation from the contractor or oral comments at the exit conference.

[GAGAS 4.35](#) states "When auditors receive written comments from the responsible officials, they should include in their report a copy of the official's written comments, or a summary of the comments received. When the responsible officials provide oral comments only, auditors should prepare a summary of the oral comments and provide a copy to the responsible officials to verify that the comments are accurately stated."

GAGAS 4.37 states, "obtaining oral comments may be appropriate when, for example, there is a reporting date critical to meeting a user's needs; 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; or the auditors do not expect major disagreements with findings, conclusions, or recommendations in the draft report, or major controversies with regard to the issues discussed in the draft report." The summary of oral comments is also included as an appendix to the audit report.

h. The oral and written comments should be included in the audit report as instructed in CAM 10-208.5d(1).

### **4-304.2 Price Proposals [\\*\\*](#)**

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a. This category includes contractor proposals to establish:

- (1) initial prices under all types of negotiated contracts;
- (2) successive target prices and interim prospective prices under FPR- and FPI-type contracts;
- (3) price changes for contract change orders;
- (4) other contract price adjustments and Contract Disputes Act (CDA) claims including those for alleged delay and disruption and requests for extraordinary contractual relief;
- (5) forward pricing rate agreements; and
- (6) special rates.

Treat the incurred cost portion of final FPR/FPI price redetermination proposals, equitable adjustment proposals and CDA claims as an incurred cost proposal (4-304.4) and the projected portion under this paragraph.

b. Discuss any factual differences found during the audit with the contractor and obtain a reaction for further analysis or inclusion in the audit report. However, pursuant to [FAR 15.404-2\(c\)\(1\)\(i\)](#), do not disclose to the contractor the audit conclusions and recommendations on projected costs or rates that are subject to contracting officer negotiation, except as specifically requested by the negotiating contracting officer. (Discussion of actual cost submissions, even if subject to negotiation, is covered in 4-304.4.) As an example, a labor cost estimate proposed by the contractor may reflect a learning or improvement trend different from the contractor's prior cost experience, with no apparent justification. In this example, you would discuss with the contractor the factual aspects of the prior cost experience and inquire why the experienced trend was not considered appropriate to project future costs. You would not, however, discuss your audit conclusions or disclose the amount of proposed labor costs to be questioned, if any, in the audit report. As another example, the auditor would discuss with the contractor why a proposed raw material factor was based on history from the development phase of a particular contract when the contractor has available more current and relevant history from follow-on production contracts. In this case, the auditor would not disclose the audit conclusion (e.g., that DCAA's results were based on the history for the follow-on productions contracts) or the overall questioned cost, the questioned cost by cost element, or how much of a specific rate/factor was questioned unless specifically directed to do so by the requestor.

c. Discuss with the contractor any discrepancies noted in the certified cost or pricing data, as defined in [FAR 2.101](#), whether they increase or decrease the contract price. As part of these discussions, inform the contractor of any certified cost or pricing data found to be inaccurate, incomplete, or noncurrent. Confine the discussions to factual aspects of the data, and do not attempt to influence the contractor to change the proposal. Any changes in the proposal should be based on the contractor's own

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initiative by formal written submission to the contracting officer.

d. Advise the contractor of any costs to be reported as unsupported (see CAM 10- 304.8c).

e. Discuss with the contractor any other CAS and FAR noncompliances found during the audit and, as appropriate, provide details for the contractor's analysis and reaction.

### **4-304.3 Postaward Audits of Certified Cost or Pricing Data for Possible Defective Pricing <sup>\*\*</sup>**

a. Discuss any factual indication that certified cost or pricing data may have been defective to afford the contractor an opportunity (normally 30 days) to review the matter and provide any additional information for the auditor's consideration. A draft copy of the report exhibit(s) and accompanying footnotes normally should be provided to the contractor. Final determination as to the existence and extent of defective pricing remains the responsibility of the contracting officer.

b. The contracting officer should also be provided the draft report exhibit(s) and accompanying footnotes on apparent defective pricing issues and given the opportunity to provide comments. See CAM 14-122 regarding discussions of the audit findings with the contracting officer. The auditor should discuss the findings throughout the course of the audit rather than only at the end.

c. The contractor may contend that there were understated estimates offsetting any potential price reduction that would result from a contracting officer's defective pricing determination. Request the contractor provide appropriate certification and specific data supporting the offsets for audit evaluation and inclusion in the audit report (see CAM 14-118 and CAM 10-606.5d).

d. Although the auditor should not expend resources examining uncertified contractor offsets, the auditor should objectively disclose all of the facts known. Therefore, apparent offsets discovered during the postaward audit should be disclosed to the contractor for its analysis and offset submission if the contractor deems appropriate. (Refer to CAM 14-118 for treatment of offsets in the audit position on recommended price adjustments).

e. Coordination and discussion of the findings by all parties before the audit report is issued can minimize delays in the resolution process. Postaward audit reports should not be issued until the initial findings have been properly coordinated to ensure that findings are based on a complete understanding of all the pertinent facts.

### **4-304.4 Incurred Cost Proposals <sup>\*\*</sup>**

a. This category includes cost reimbursement vouchers and contractor representations of incurred costs to establish:

(1) final prices on all types of completed negotiated contracts,

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- (2) final indirect cost rates,
- (3) contract termination settlements, and
- (4) equitable adjustment proposals and CDA claims.

Contractor requests for progress payments authorized by the contract will be treated under this paragraph even though projected costs are involved in the calculations. Proposals to establish special rates and interim changes in contract prices are covered in 4-304.2.

b. Discuss all audit conclusions with the contractor's designated official and try to obtain the contractor's concurrence regarding any questions of conformity with generally accepted accounting principles, applicable cost accounting standards, and other cost principles incorporated in the contract(s). If there are audit exceptions to be reported, request the contractor's official reaction for inclusion in the audit report or in the notice of costs suspended or disapproved.

c. See CAM 6-902c and d for special discussion procedures on costs to be suspended or disapproved under cost-reimbursement-type contracts.

d. As discussed in CAM 6-902e, the auditor should notify the ACO of developing issues which may result in the issuance of a [DCAA Form 1](#) as follows:

(1) Provide the ACO with written documentation of the audit results which were discussed with the contractor at the exit conference, unless the contractor immediately agreed to all audit exceptions and the written report will be issued within the next 30 days. The written documentation may be in the form of a memorandum to the ACO, a copy of a memorandum for the file setting forth the results of the exit conference, copies of a draft report exhibit and/or notes, or copies of working paper exhibits and/or supporting working papers. In other words, provide the ACO with whatever information or subset thereof that was provided to the contractor at the exit conference.

(2) Provide the ACO a copy of the contractor's written rebuttal to the audit findings immediately upon receipt.

(3) Discuss significant unresolved issues with the ACO at any mutually agreeable time.

### **4-304.5 Operations Audits – Exit Conferences\*\***

a. This paragraph covers evaluations of contractor's operations for economy and efficiency and financial compliance, including audits of internal controls, major system surveys, and joint reviews under [DFARS Subpart 242.70](#).

b. After full discussion of each matter requiring contractor action, provide the contractor a draft statement of the condition(s) and recommendations. Carefully design the discussions and drafts to elicit contractor concurrence with recommended

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system improvements and/or cost avoidance. Request an official written response for inclusion in the audit report, and establish a time frame for the contractor's response. Allow ample time for the contractor to consider the audit presentations, and consider alternatives the contractor may suggest that will satisfy the audit objectives.

c. If the contractor does not agree with the audit recommendations and provides a response, the auditor should provide in the report comments specifically on the contractor's response. If specialist or technical assistance is required in evaluating those alternatives, the auditor should obtain the assistance. Do not merely restate or amplify a position already stated.

d. If the evaluation results in cost avoidance recommendations, make the contractor aware that, effective immediately, any impact of such recommendations will be reflected as questioned costs in reports on price proposal evaluations when applicable (in accordance with the criteria in 9-308).

e. See further guidance on discussion of audit findings as part of a team review in 5-1302 (contractor's purchasing system review team), 5-1303 (contractor's insurance/pension review team), and 5-1200 (surveys of contractor estimating systems).

### **4-304.6 Cost Accounting Standards Audits \*\***

a. This paragraph covers CAS disclosure statement adequacy audits, compliance audits (including audit reports on CAS noncompliance), and cost impact proposal audits.

b. Discuss the results of adequacy audits with the contractor. If one or more disclosures are considered inadequate, provide the contractor a draft copy of the audit report for its comments. The letter transmitting the draft audit report should solicit the contractor's specific comments on the adequacy issues and advise that the comments will be included in the audit report if received by a specified date. Provide the contractor a reasonable period of time to respond to the draft audit report. Do not delay issuing the report, however, if the comments are not provided in sufficient time to permit their inclusion by the established report due date.

c. Thoroughly discuss apparent CAS noncompliances with the contractor to establish that the audit findings are based on a proper understanding of the issues and that all pertinent facts have been considered. Do not state that the auditor is making a determination of noncompliance, since the contracting officer makes this determination. Provide the contractor a draft copy of the audit report for its comments. The letter transmitting the draft audit report should solicit the contractor's specific comments on the compliance issues and advise that the comments will be included in the audit report if received by a specified date.

d. Discuss the results of cost impact proposal audits with the contractor to establish that the audit findings are based on a proper understanding of the issues and that all pertinent facts have been considered. Provide the contractor a draft copy of the

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audit report for its comments. The letter transmitting the draft audit report should solicit the contractor's specific comments on the audit exceptions and advise that the comments will be included in the audit report if received by a specified date.

### **4-304.7 Litigation Support \*\***

a. Audit work is privileged when performed at the request of Government litigation counsel in support of ongoing or anticipated litigation (see CAM 15-503). If there is reason to believe that the audit has been requested in support of litigation, the auditor should ask the requestor to state whether the audit will be covered by the attorney work product privilege. If so, an exit conference could compromise the privilege. When audit work is covered by the attorney work product privilege, the auditor should explain the importance of the exit conference in resolving audit issues and avoiding errors, and attempt to obtain permission to hold an exit conference. However, to prevent inadvertent compromise of the attorney work product privilege, an exit conference must not be held without litigation counsel's written consent and coordination on the matters to be discussed.

b. Litigation support should not be confused with investigation support (see 4-702.6). In litigation support, audit access arises from contractual requirements.

## **4-400 Section 4 - Audit Working Papers \*\***

### **4-401 Introduction \*\***

This section contains guidance for the preparation, format, contents, and filing of audit working papers, whether prepared manually or using computers. The preparation of working papers assists the auditor in accomplishing the objectives of an audit assignment and serve as the principle support for the conclusions in the audit report. They also provide a record of the work performed; record of communications with the contractor and/or Government personnel; evidence of adequate supervision; are used as supporting data during negotiations, appeals, and litigations; and provide a basis for any other quality assurance reviews.

### **4-402 General \*\***

a. Extensive copying of contractor records for inclusion in working papers is unnecessary. It is generally sufficient to reference the records and source documents examined during the course of the audit. However, where audit exceptions are found and reported, the working papers should include copies of the evidential material examined, including contractor source documents.

b. Auditors should prepare and maintain audit working papers on a current basis. Working papers should reflect the progress of the audit, ensure continuity of audit effort, and permit reassignment of auditors without significant loss of time.

c. The audit report is not a working paper. It summarizes and reports the Agency's final conclusion on the Subject of Audit, based on the data and analysis documented in

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the working papers. The working papers must support the final conclusion(s) reached. Auditors should follow 4-403f, which discusses superseded working papers, for guidance on the treatment of working papers that do not support the final report conclusion(s). Only the final report and the final cross-referenced draft should be retained in the original file.

d. The nature of working papers requires that proper control and adequate safeguards be maintained at all times. Working papers frequently reflect information considered confidential by the contractor, marked "For Official Use Only," or classified for Government security purposes.

e. E-mail is used to routinely communicate audit related information within DCAA. When sending e-mail within DCAA, the use of compression software is recommended for anything in excess of 500KB in size. In addition, auditors should ensure recipients have enough information in the subject and body of the e-mail to efficiently identify the subject matter (typically, without opening the attachments). Items that should be considered for inclusion (as appropriate) are as follows:

- (1) audit assignment number (if not already in an attached filename),
- (2) if inter-FAO correspondence, consider using the assignment number established by the requesting FAO, which is more meaningful to them,
- (3) contractor name,
- (4) assignment subject.

See CAM 10-203.9 for guidelines on preparation of e-mails to customers, including use of compression software.

### **4-403 Format and Contents of Working Papers \*\***

a. Standardization in design, content, and arrangement of working papers is desirable because it facilitates the audit, the supervisory auditor's review, and report preparation. This section provides guidance on the Agency's standard working paper format.

b. Conditions and circumstances vary with each audit. The nature, timing and extent of audit documentation require the exercise of professional judgment. A constant awareness of the purpose and use to be made of working papers is helpful in determining their content. See guidance in 4-410 and CAM 10-214.1d on revisions to audit working papers after the audit report is issued.

c. Working papers can consist of electronic files, such as spreadsheets, word-processing files, graphical images, etc., as well as hardcopy documents when electronic files are not practical. Auditors should strive to use electronic working papers, to the extent possible, to capture the efficiencies provided by information technology, such as storage, search functions, accuracy, and processing speed.

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d. Two types of working papers are generated during the audit -- administrative working papers and audit working papers.

e. Administrative working papers do not document field work or audit procedures. The administrative working papers generally contain information and documentation that is used internally by the Agency. Figure 4-4-2 contains an outline of the Agency standard administrative working papers. Each audit working paper package will include an index of the Administrative Working Papers. Administrative working papers typically include:

(1) notes or correspondence documenting interaction with Government or contractor representatives;

(2) an audit report or memorandum to document the completion of the assignment;

(3) DMIS data entries (including computations of dollars audited and cost savings); and

(4) audit lead sheets. An audit lead sheet should be prepared when an issue arises that an auditor feels needs to be addressed, but is not an area within the scope of the current audit. Auditors should provide a brief description of audit leads, identify areas potentially impacted, and suggest audit steps, if appropriate. Supervisors will review draft lead sheets and provide directions for appropriate follow-up. The timing for follow-up on the audit lead will be based on risk. Appropriate follow-up may include documenting specific consideration in appropriate future assignment(s), immediately establishing a new assignment to review the lead, or providing additional guidance to review the lead in the current assignment. Final approved audit lead sheets are to be maintained in the originating assignment working papers, as well as the FAO contractor permanent file. Supervisors are responsible for ensuring audit leads are addressed, documented, and dispositioned appropriately. Field office managers are responsible for reviewing audit lead sheets periodically to verify appropriate actions have been taken.

f. Audit working papers are generated during the field work portion of the audit to document the significant conclusions and judgments of the auditor. They should contain descriptions of the transactions and records examined, and the objectives, scope, and methodology (audit procedures) used to develop the conclusions. The audit working paper file consists of current working papers and, if applicable, superseded working papers. A description and discussion of current, and superseded working papers and working papers for cancelled assignments follows.

(1) Current working papers. Current working papers should be relevant to the audit assignment and support the report conclusions. In preparing current file working papers, the auditor should not unnecessarily duplicate information contained elsewhere in the same audit assignment or located in the permanent file. Frequently, the most expeditious method is to reference the permanent file data to the current file (see 4-405 for information pertaining to permanent files). GAGAS field work standards on audit



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documentation require that working papers be appropriately detailed and organized to provide a clear link to the findings, conclusions, and recommendations contained in the report. When a revision in audit scope occurs, the working papers that document the audit field work, and conclusions based on the revised scope, are classified as current working papers because they are relevant to the reported audit conclusion. An increase or decrease in audit scope should be adequately documented as part of the “revised scope” working papers. If the revision in the audit scope is significantly different from the working paper B risk assessment, the auditor should also make a notation in this section as well. The documentation, in all cases, should briefly describe the original audit scope and the reason for the revision in scope.

Working papers should also contain evidence of supervisory review of the work performed. Figure 4-4-1 contains an outline of the Agency's standard working paper format and the indexing protocol for audit working papers. Each audit working paper package will include an index of Audit Working Papers (4-403 I (2)).

(2) Superseded working papers. Superseded working papers should be clearly identified as such and include any working papers prepared during the course of the audit that do not support or are not relevant to the conclusions in the audit report. This will include, for example, working papers changed due to revisions in audit methodology that are not relevant to the audit conclusions.

(3) Working papers for cancelled assignments. Working papers for all cancelled assignments should be retained and filed in Livelink regardless of the number of hours charged. For assignments cancelled with 8 or more hours, auditors should prepare a MFR to fully document the audit work performed and why the assignment was cancelled. If notification/acknowledgment letters were issued to the contractor and contracting officer, the auditor should inform them that the audit has been terminated/cancelled and document that communication. If the contractor and contracting officer were notified of the assignment informally (e.g., verbally or e-mail), the auditor should also inform them that the audit has been terminated/cancelled in a similar manner and document that communication. Auditors and supervisors should generally use judgment in deciding whether to prepare a MFR for cancelled assignments with less than 8 hours. However, documentation requirements for unreconciled difference of opinion must always be followed even when the assignment is cancelled (4-409(d)).

g. The following is a description of the major audit working paper sections:

(1) W/P Section A -- Summary working paper section contains:

- The summary of audit results, executive summary, and subject of audit to be forwarded into the draft audit report (see Chapter 10);
- The customer's special requests and requirements (if any);
- The audit criteria (e.g., FAR, DFARS, CAS);

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- Initial supervisory guidance and audit objectives;
- Concluding audit steps; and
- Interim/final supervisory guidance and review

(2) W/P Section B -- Risk assessment and preliminary review working paper section contains:

- A summary of the risk assessment and the impact the risk assessment has on the substantive testing required to accomplish the audit objectives;
- The audit report note on the assessment of control risk (see CAM 5-109);
- Documentation on the examination of internal controls (Internal Control Audit Planning Summaries (ICAPS) or the Internal Control Questionnaire (ICQ), as appropriate) and the impact of this assessment on the audit;
- Documentation on the evaluation of materiality and sensitivity factors, and the impact of this evaluation on the audit;
- Documentation on the evaluation of reliance on computer based data and the impact of this evaluation on the audit;
- Documentation on the evaluation of inherent and other risk factors (e.g., permanent files, prior findings, contract mix, Government participation, audit lead sheets), and the impact of this evaluation on the audit;
- Accomplishment of other preliminary audit steps that do not relate to auditing a specific cost element/area; and
- Assessment of need for technical assistance and/or assist audit(s) and the related request(s);

(3) Lead working papers and related audit program (e.g., wp/C-01) contain:

- The lead schedule for each cost element/area being evaluated (e.g., schedule of proposed and questioned amounts, schedule of control objectives audited and the results);
- The tailored audit steps for the evaluation of that cost element/area; and
- The structured audit report note (see CAM 10-211.2), for inclusion in the audit report, which describes the work performed for the cost element/area being audited.

The structured note format should be used even if the cost element/audit area will be excluded from the audit report. The structured note will address the following

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topics:

- (a) Summary of Conclusions
- (b) Basis of Contractor's Costs
- (c) Audit Evaluation
- (d) Contractor's Reaction
- (e) Auditor's Response

Another form of the structured note is the Statement of Condition and Recommendation. This format is used for internal control examinations, operations audits (refer to CAM 10-409) and CAS audits (refer to the appropriate Results of Audit section in CAM 10-800). If there are no findings, for these activities provide a narrative summary of the audit area, the audit work performed and a conclusion indicating no exception was taken.

(4) Detailed working papers contain:

- The supporting data, information, schedules, and computations for the audit steps on the applicable lead working paper.
- The on-page notes that document accomplishing the tailored audit steps, support the significant audit judgments and conclusions, and describe the transactions and records examined. These notes will address the following:

Purpose – state the specific purpose of the working paper on each working paper or the first page of a group of related working papers. Avoid using general phrases such as “Review Labor” or “Review Material”.

- Include enough information to make it evident why we created the working paper and the reason why we are performing the audit step. The wording of the purpose should align with the audit program steps that the working paper will satisfy.

Source of Information – identify the source of data or information shown on each working paper. The statement should include the name, title, and department of the individual who provided the information. If beneficial, also provide the receipt date. If the information comes from a contractor-generated report, provide the name and date of the report. Also, if the data was obtained from the contractor’s systems, indicate how the information was obtained to facilitate another auditor obtaining the same type of information at a later date. If the information came from the FAO permanent file, the auditor should provide specific information regarding the source of the information, not merely referencing “permanent file”. Generalized

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statements, such as “contractor’s accounting records,” or “Jane Doe” are not sufficient.

Scope of Analysis – provide a detailed description of the scope of the audit work performed to create the working paper. Include appropriate explanations when the scope has been limited or unusually expanded, including sampling plan or judgmental selection details when appropriate (see note below regarding transaction testing documentation requirements). It should also include the specific criteria (e.g., [FAR 31.205-33](#), [CAS 48 CFR 9904.412](#)) used to make the judgments and conclusions. Avoid using generic phrases, such as “reviewed the rates”.

Auditor’s Conclusions and Recommendations – at the time of determination, document the conclusions and recommendations on the working paper. For a group of related working papers, a single conclusion on the first page of the group is acceptable. The conclusion should not duplicate, but should relate to, the information included in the purpose (e.g., if the purpose of the working paper is to determine the acceptability of costs, the conclusion should state whether the costs were acceptable).

- If the working paper is an Excel spreadsheet and contains multiple tabs, it is not necessary to include the purpose, source, scope and auditor conclusion and recommendation (P,S,S,C) on each tab of the worksheet provided the work on the tab is understandable and supported by the P,S,S,C included on the lead tab for the working paper.
- Document the following in the working papers when selecting items for transaction testing, regardless of the method of selecting the items. (Refer to the Variable and Attribute Sampling Guidebooks for additional information regarding statistical sampling documentation.)
  1. A description of the universe from which the items are selected, including specific source information (e.g., contractor’s January 1, 20XX bill of material totaling \$2.5 million).
  2. Identification of the items to be tested (e.g., material parts with an extended value over \$50 thousand) and the attributes to be tested.
  3. When judgmental selection techniques are used, include an explanation describing how the selection results in adequate audit coverage of the universe to meet the audit objectives (e.g., We judgmentally selected 35 items/transactions of the 345 in the universe which represent 60% of the dollars. The remaining 310 items/transactions or 40% of the dollars are composed of small dollar items and similar transactions. Therefore, in our opinion, because of the similar transaction types and the results of our review of the 35 items/transactions, which disclosed no material misstatement, we

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believe we have sufficiently addressed the risk in our review and can opine on the universe.).

h. Auditors are to prepare working papers in electronic format to the maximum extent possible. The APPS incorporates working paper templates and audit report shells that must be used for most audit activity codes. If use of the APPS is not mandatory for a particular activity code, it will be indicated next to the assignment number in the APPS tab when entering the assignment in DMIS.

### i. Naming Conventions:

(1) To simplify the indexing process in an electronic environment, DCAA has adopted a standardized file naming convention. This convention also establishes standardized procedures for storing in-process electronic working papers, as follows (see 4-407e. for naming conventions related to closing actions):

- Each auditor should have a folder named "Audit Working Papers" on the hard drive of his or her primary computer.
- For each assigned audit, the APPS software will establish a new folder within the Audit Working Papers folder. This new folder is assignment specific and will be given the actual assignment name, such as: 02441\_2005B21000001. All in-process electronic working papers will be stored within the appropriate electronic assignment folder. DCAA electronic working paper software supports this naming and storing convention.

(2) Detailed and administrative file names should beginning with the actual working paper reference, such as B-02a, T-04, etc. This will be followed with a brief description or actual title of the working paper, such as Evaluation of Engineering Labor Rates or Determination of Current Labor Rates. The combined result will make the identification of electronic working papers much clearer. An example of the file naming convention is shown below:

W/P	Description
08c-1	Contractor's Explanation of Depreciation (email)
11	Audit Acknowledgement Memo – Assignment No. xxx
D-02	D-02 Detailed Evaluation of Labor Rates.doc
D-02a	D-02a Determination of Current Labor Rates.xls

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D-02a-1	Actual Engineering Rates to Date.doc
---------	--------------------------------------

To make it easier to find documents, auditors should make use of longer, more descriptive file names.

j. Working papers should contain the following information:

(1) **Heading.** Head each working paper with the name of the contractor, the assignment number, and a title or description. The title or description should convey the purpose of the working papers. Most working papers generated using the Agency electronic working paper application will collect and automatically generate the appropriate headings based on user-supplied input.

(2) **Auditor's and Supervisor's Initials and Date.** The requirement for the auditor's and supervisor's initials and dating applies to both hardcopy documents and electronic working papers. The work of all auditors contributing to the working paper content, including that of technical specialists, should be identified to the individual work product. The auditor who prepares or completes a working paper should place his or her initials and the month, day, and year the work was performed or completed on each sheet. If the auditor verifies a multiple-page, contractor-prepared document (e.g., bill of material), the auditor should place his or her initials and the date on only the first page of such document. To facilitate the use of electronic tools and provide a standard location for reviewers, the auditor normally identifies his/her work by initialing in the lower right corner of the audit working paper. When the software is not conducive to this location (e.g., spreadsheets) working paper attributes (e.g., assignment number, initials, date) should be placed in a prominent location. When preparing or completing electronic working papers, the auditor's initials will be typed in by the auditor using the bold italic font, which will set the auditor's initials out from the text of the working papers.

An acceptable example:

***W.H.R.***

***12/16/03***

Color fonts may also be used to further distinguish initials and dates; however, care should be taken in selecting colors that are easy to read, even when printed on a non-color printer. It is not necessary for supervisors to indicate their review and approval on each working paper; however, supervisory guidance, review, and approval must be evident in the working papers. As a minimum, to indicate final review and approval of the work, supervisors should initial and date the lead working papers, the top page of the summary working paper section, the top page of the risk assessment/preliminary review section, and the top page of the draft audit report. As with the auditor's initials, the supervisor's initials on electronic working papers should be in the bold italic font to easily distinguish the supervisor's initials from the audit working paper text. APPS provides space for auditor initials and date in the lower right corner of audit working papers, as appropriate. Space is also provided for

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supervisory approvals. Initialing these documents is evidence that the working papers have been reviewed to the extent necessary for the supervisor to ensure the audit objectives have been accomplished and there is adequate evidential matter to support the audit findings (also see CAM 2-S103.4b(4)).

(3) References. The working paper reference scheme should follow a "top-down" approach. Avoid referring from lower level working papers (i.e., detailed working papers) to higher level working papers (i.e., lead and summary working papers). As a minimum, reference the following:

- All significant judgments, findings, conclusions, and recommendations that are included in the draft report. This includes: summary results and notes to the summary and lead working papers; the report scope section on how the contractor's internal control systems affected the scope of audit; all report qualifications; and if applicable, the Other Matters section of the report.
- Information in the summary working papers to the related lead working papers.
- Risk assessment/preliminary review working papers to the related detailed working papers.
- The lead working papers to the detailed working papers.
- The detailed working papers to the next lower level of supporting working papers.

Audit working papers may follow the top-down approach using any one of the following examples:

- See W/P K-02a
- Source W/P K-02a
- W/P K-02a

All are acceptable, provided they clearly direct the auditor to the appropriate source working paper. It may be preferable to provide a more detailed reference, such as: "See W/P L-1, line 45, column B". The level of reference detail is subject to individual auditor judgment and to any supervisory or FAO specific preferences.

Electronic working papers can complicate the referencing process. Windows based software packages allow for electronic references to source data. Specifically, such functions as hyperlinks, copy and paste, linked objects, embedded objects, etc., increase the auditor's ability to manipulate data within and between working papers. Auditors are encouraged to make use of this technology; however, it is essential to maintain the requirement to specifically annotate the appropriate working paper

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reference.

k. **Stated References.** Electronic working papers and the draft audit reports that are electronically referenced must also include a stated reference. A stated reference is an actual working paper reference, such as A-01, B-02a, T-04, etc. Maintaining a stated reference within the electronic working paper is a sound business practice. It may be needed if the working paper is printed at a later date. Hyperlinks are excellent navigational aids, but the electronic links can be severed, making the stated reference the only navigational aid to the supporting documentation. Similar to the designation of auditor and supervisory initials, working paper references should be distinguished using the Bold Italic font. Color fonts may also be used to further distinguish working paper references; however, care should be taken in selecting colors that are easy to read when printed. There are APPS Tools (Quick Links) available to aid auditors when developing hyperlinks that take advantage of using stated references. These tools will also apply the desired attributes (bold, color, italics).

### I. Indexing.

(1) Index each working paper as it is prepared. The Agency standard indexing protocol is described in Figure 4-4-1. In practice, auditor working paper packages can consist entirely of electronic files or include a mix of electronic files and hardcopy working papers. Each audit working paper package, whether in electronic or hardcopy form, will follow the standard indexing structure.

(2) Every audit working paper package should include an index of the Administrative and Audit Working Papers. The required index is provided by APPS as working paper 00 Working Paper Index. It automatically generates a listing of all electronic documents in the assignment folder within the Audit Working Papers folder, organized in accordance with the Agency standard indexing protocol as described in Figure 4-4-1. It also provides entries for the standard administrative working papers as described in Figure 4-4-2. If there is an electronic version for a particular administrative working paper entry, the index removes the entry and lists the electronic file. Hard copy working papers should be added to this index and noted in the description column. If the assigned file name does not adequately describe the electronic file, additional narrative should be provided in the description column. Entries for any unused administrative working papers with no electronic file should be removed at the conclusion of the audit using the index's function for that purpose so that it is clear that those working papers are not a part of the working paper package.

m. When the audit report has been electronically transmitted to the customer, the exact same file transmitted must be included in the working paper package (see 4-407e.(2)). An electronic copy of the draft audit report, cross-referenced to the working papers, and an electronic version of the acknowledgment letter must be retained in the audit working paper package.

### [Figure 4-4-1](#)



### Standard Working Paper Format and Indexing **\*\***

Summary Working Paper, which includes:	A
• Audit Summary	
• Executive Summary	
• Results of Audit	
The following working papers are also required:	
• Planning Document, which includes:	A-01
• Subject of Audit	
• Initial Supervisory Guidance/Audit Objectives	
• Concluding Audit Steps	
• Interim Guidance/Corrective Actions	A-02
• Final Review Comments	A-03
Risk Assessment/Preliminary Review Working Paper	B
• Summary of Risk Assessment	
The following working papers are also required:	
• Audit Planning Considerations/Preliminary Audit Steps	B-01
• Documentation of Risk and Assessment of Internal Controls	B-02
• Assessment of Need for Technical Assistance/Assist Audit	B-03
Lead Working Papers	C, D, etc.
• Tailored Audit Steps for the Cost Element/Area Being Audited	C-01, D-01, etc.
• Detailed Working Papers	C-02, D-02, etc.
• Supporting Working Papers	C-02a, D-02a, etc.

Note: Electronic indexing of page numbers should be done using currently available means within the software application in which the work is performed. Hard copy indexing of page numbers should be done using the format: A (1/3), A (2/3), A (3/3)

**Figure 4-4-2**

### Administrative Working Papers

Following are the contents of the Agency administrative working papers section and their sequence:

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- 01           REPORTS, LEADS, DMIS DATA
  - Audit Report/Memorandum
- 01a           Cumulative Allowable Cost Worksheet (CACWS)
- 02           Computation of Dollars Audited & Cost Savings
- 03           Defective Pricing Lead Sheets
- 04
- 05           Audit Leads
- CORRESPONDENCE
- 06a           Entrance Conference Notes
- 06b           Exit Conference Notes
- 07           Government Notes / Correspondence
- 08           Contractor Notes / Correspondence
- 09           Technical Report
- 10           Assist Audit Reports
- 11           Acknowledgment / Notification Letter (Original / Revised)
- 12           Request For Audit/Other Engagement (Original / Revised)
- PERMANENT FILE UPDATE WORKING PAPERS
- 13           ICAPS/ICQs Sections
- 14           Contract Briefs
- AGENCY ADMINISTRATIVE WORKING PAPERS

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- 15a Livelink Input Form
- 16a Closing Actions
- 16b Tick Marks Legend
- 17 Permanent File Setup-Update

### FAO SPECIFIC WORKING PAPERS

- 18
- 19
- 20
- 21

### CONTRACTOR'S SUBMISSION, DATA, ETC.

- 22 Contractor's Submission, Data
- 23 Revised Contract Submission / Data

### OTHER HEADQUARTERS GUIDANCE OR WORKSHEETS

- 30 Other Audit Guidance (or worksheets)
- 31 Activity Code Specific Policy Guidance (or worksheets)
- 32 Independent Reference Review
- 34 Audit Specific Independence Determination
- 35 Legal Guidance

#### **4-404 Working Papers - Agenda Sheet \*\***

During the assignment, matters may arise that are not settled immediately either because the information is not available or the auditor wishes to avoid interrupting the

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work at hand. The auditor should develop a separate agenda sheet or "To Do" sheet listing matters for further examination as the audit proceeds. Before completion of the audit, each item on the agenda sheet should be resolved. Items which may be placed on the agenda sheet include:

- (1) Differences to be investigated.
- (2) Items to be discussed with contractor personnel.
- (3) Additional audit steps to be performed after preparation of an analysis or schedule.
- (4) Unavailable contractor records to be examined later.
- (5) Follow-up on partially completed transactions.
- (6) Items requiring discussion with or approval of the contracting officer or technical or supervisory personnel.

### **4-405 Permanent File \*\***

a. The permanent file on each contractor is a central repository of information gathered during audits that has continuing value and use to subsequent audits expected to be performed at the same contractor. Permanent files are useful in preparing the audit program and in determining the appropriate scope of subsequent audits. They also provide ready means for auditors to become familiar with the contractor's operations and any existing audit problems or contractor system weaknesses. While summary information on the contractor's organization, financial structure, and policies and procedures may sometimes be included in permanent files for smaller contractors, such information on large contractors with continuing audit activity is generally maintained in the field audit office at a central reference library.

b. The third mandatory annual audit requirement (MAAR) is to maintain and update permanent files for new or changed contractor organizations, operations, policies, procedures, internal controls, software programs, and accounting methods that influence the nature, level, and accounting treatment of costs being charged or to be charged to Government contracts. This also includes the update to documentation on the contractor's contract briefing system or auditor-prepared contract briefs. This mandatory annual audit requirement ensures that any of the above type information gleaned from current audit work is summarized or referenced where it is likely to have a continuing value to subsequent audit work. It is not necessary to establish separate audit assignments to gather organizational or procedural manual changes, and to file such information in the permanent files when it has no immediate or obvious influence on future audit assignments. In distinguishing between what is needed and all other information, the auditor must exercise judgment. Additional guidance for both major and nonmajor contractors is in the [DCAA Management Information System \(DMIS\)](#).

c. Auditors often refer to prior current audit working paper files as the permanent

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files. This is especially true with indirect cost audit files that contain audited contract cost information. Accordingly, when prior audit files contain information that would likely be useful in the performance of future audits, and it is not practical to transfer the data to a separate permanent file, the auditor should maintain and properly reference the prior audit file as part of the permanent file. Steps should be included in each current audit to identify the types of information that should be placed in the permanent file (see 4-405f). Auditors using the permanent file during a current audit are also expected to identify permanent file information that is outdated or no longer considered useful for future assignments. The auditor should submit recommendations to the supervisory auditor for removal of such data from the permanent file. The supervisory auditor should consider if the data is necessary for supporting GAGAS audits that are being relied upon prior to authorizing removal.

d. The permanent files should be maintained in a convenient, accessible manner. [The Electronic Contractor Permanent File \(ECPF\)](#) system is the Agency's standard tool for maintaining contractor permanent file records. During field visits to contractor locations, auditors are encouraged to obtain information electronically, if possible, to facilitate storage and maintenance of records in the ECPF system.

e. The structure of the ECPF uses a folder with the contractor name and DUNS number, and includes 13 primary folders subordinated to it. The primary folders are lettered A through M, as follows:

A-General Contractor Information

B-Audit Planning

C-Financial Capability

D-Financial Information

E-EVMS

F-Contract Information

G-Correspondence

H-ICAPS/ICQ

I-CAS

J-Forward Pricing

K-Incurred Cost-Indirect rates

L-Operations Audits

M-Miscellaneous

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The primary folders also contain numerous subfolders, and there are versions available for both contractors with ICAPS and contractors with ICQs. The FAO can file at any level within the system of folders. Depending on the size and complexity of the contractor, the FAO can file in as simple or complex a fashion as required. Instructions and tools related to the creation, implementation, and use of the ECPF are located on the DCAA website under [Comp Support/File Libraries](#).

f. The following items would logically be included in the permanent file as having continuing value in future audit assignments:

- (1) Internal control audit planning summary (ICAPS) sheets.
- (2) Internal control questionnaires (ICQ).
- (3) MAARs control log.
- (4) Disclosure statement and revisions in accordance with CAS rules and regulations.
- (5) CAS planning and cycling documentation.
- (6) CAS compliance and noncompliance tracking.
- (7) DMIS CAS Tracking of Issued Noncompliance (19200) Report (After FY 1991).
- (8) Audit lead sheets.
- (9) Internal control system planning and cycling documentation.
- (10) Historical pension cost information. At a minimum include the following information for each defined benefit plan by fiscal year:

(a) For contractors not separately calculating pension costs by segment – total costs incurred, the contractor's established allocation base to allocate pension costs to segments, and the Government's participation in the allocation base, even if no pension costs were incurred for the year.

(b) For contractors calculating pension costs by segment – for each segment: total costs incurred, the portion of the costs allocated to contracts subject to CAS and FAR Cost Principles, and the year-end pension asset balance (market value), even if no pension costs were incurred for the year.

- (11) Cumulative Allowable Cost Worksheet (CACWS).

### **4-406 Copies of Contractor Data in Working Papers \*\***

a. When considering the extent of the contractor's data that should be copied and retained in the working paper files, the auditor should use the following guidelines:

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(1) The audit file should contain copies of the contractor's records as part of the audit documentation if they are needed to enable an experienced auditor to understand the work performed, the evidence obtained and its source, and conclusions reached. The auditor should consider the continuing availability of source documents and contract data retention requirements when deciding whether to reference or reproduce contractor source documents.

(2) Where a particularly sensitive or material audit conclusion hinges on key source documents and referencing would not provide sufficient evidence of the content, copies should be included in the working papers. This same consideration applies when the audit results can give rise to a Government claim against the contractor, such as an assertion of defective pricing or an allegation of CAS noncompliance. In these situations, the contractor data should be retained in the working paper files for consideration by the contracting officer in his/her decision making processes. More routine audit conclusions may be sufficiently documented by reference and extraction of pertinent information.

(3) The auditor should recognize contractor concerns about reproducing copies of sensitive financial or other operating information. Instead of making copies, the auditor should take notes or extracts if this will satisfy the Government Auditing Standards (see above) and the needs of the contracting officer can be accomplished with a reasonable expenditure of audit effort.

b. The contractor must provide reasonable access to all records and corroborative documentary evidence necessary to achieve the audit objective. Auditors who are precluded from performing procedures considered necessary and material in the circumstances, including reproducing contractor records and documents, should follow Agency access to records guidance (see 1-504).

c. Scanned Documents. The decision to transfer hardcopy documentation to electronic form (scanning) is a matter for auditor judgment. When presented as evidence in litigation, the courts will treat a document reproduced from electronic format as an original. Documents which might be scanned include correspondence, invoices, travel vouchers, quotes, and similar records. Special care must be taken to avoid any alteration or appearance of alteration of the data. DCAA scanner software will default to saving scanned documents as image files, which cannot readily be modified. The software also has the capability to convert a scanned document to Optical Character Recognition (OCR) form. OCR scans are subject to transcription error and may easily be changed in word processing and spreadsheet programs. Agency policy requires scanned documents to be saved in PDF image format.

### **4-407 Computer-Aided Working Papers \*\***

Agency standard naming conventions (see 4-403i) should be carried throughout the audit working paper package, including storage of the completed assignment official records and the corresponding audit report. As with any audit assignment, the integrity of our audit working papers must be maintained; this is vital with electronic audit files.

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During an audit, many interactions take place between an auditor, other team members, technical specialists, the supervisory auditor, and the FAO manager. The following requirements apply to the audit workflow process and incorporate standard procedures to protect working paper integrity, specifically the integrity of the official electronic working papers.

a. Working Paper Creation: In order to obtain the latest available guidance, the auditor must first set up an assignment in DMIS and then generate working papers using the APPS functionality in DMIS.

b. Work-In-Process Procedures (Interim): During the performance of an audit, working papers should be generated using the APPS User Interface. In particular, the report shell initially generated should be used as a starting point for drafting reports. In addition, the auditor must coordinate his/her work with the audit supervisor. This includes interim guidance as well as obtaining supervisory review and approval of individual working papers. This requires that electronic files be accessible to audit supervisors and others. Although there are many methods of transmitting electronic files between parties (common drives, physical delivery, e-mail, intranet, etc.), the primary methods facilitated by the APPS software are the use of the common LAN X: drive and e-mail for “off-line” connectors. The APPS software incorporates import and export functions to facilitate the transfer of files between personnel. When electronic audit files are returned to the auditor after supervisory review, the auditor is responsible for ensuring that only the most current audit files, i.e., the reviewed files, are included in the audit package. The APPS software facilitates this goal when the export/import functions are used, but it is still possible to overwrite a newer file with an older version in other software applications (e.g., Windows Explorer). In addition to the daily backup, the backup function should be performed just prior to performing an export. This provides a temporary backup, until the approved file is returned. In most cases, work should cease until the next import is initiated. However, if work must be performed, it should be tracked, approved, and updated after the file is imported.

c. Work-In-Process Backup: The most important computer proficiency discipline is the daily backup of current work in-process files. Files can be lost or destroyed, hard drives fail, and entire computers are sometimes stolen. Such occurrences could result in loss of the entire in-process electronic working paper package. To minimize such disruptions, the following procedures should be followed.

(1) A backup copy of in-process electronic audit files will be made at least daily. The APPS software utility functions allow auditors to easily backup their work to a location of their choosing (i.e., common drive, removable medium, etc.). The utility notifies the user when there are three or more backup files detected in the backup location for the selected audit. If the user chooses to view the list, a window is displayed with the list of backup files that can be selected to delete. Since two backups should be more than adequate, particularly if they are stored to a LAN drive, auditors should normally delete any backups that are older than the two most current backups.

(2) Auditors using portable laptops must ensure that backup files are not stored



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with the laptop computer (i.e., in the carrying bag) to avoid both being concurrently lost. The backup copy(s) should be stored in a location where loss or damage is unlikely to occur.

(3) An in-process backup set of all assignment audit files will be maintained until the entire audit and review is completed and the final electronic working papers have been stored and backed up.

d. Preparing the Completed Working Paper Package for Final Supervisory Review: The auditor should perform the following procedures when an audit has been completed and the working papers are ready for final supervisory review.

(1) A hardcopy folder will be established to consolidate and store assignment working papers. Working papers include electronic media, as well as hardcopy working paper documents that are not practical to store electronically. The hard copy folder will house the official hard copy files and the final backup electronic files on CD. In making a decision whether or not it is practical to scan hardcopy items, rather than maintain paper copies, the following factors should be considered: how long it will take to scan the hardcopy items; how often the item will be used; and any scanning preferences or guidance provided by the supervisor, FAO, or region.

(2) Electronic files should be maintained in efficient formats. As audit working files are backed up or archived, individual files and sizes comprising the backup can be viewed using WinZip. When creating the final backup, the auditor should use WinZip to identify files appearing inordinately large compared to their content. The intent of this review is to identify and remedy poor file creation techniques that contribute to unnecessarily large overall file size. The supervisory auditor should perform a similar review as part of the final review process. To aid in this review process, a File Size Review Tool is available on the DCAA Intranet as part of Other Audit Guidance. Files that directly support audit conclusions should never be removed from a backup or archive simply because they are large.

(3) All electronic working papers will be backed up just prior to performing the export for supervisory review. The APPS software removes original files from the personal computers and places them on the LAN X: drive for importing and eventual archiving. The auditor will maintain the backup files until a final permanent backup is created from the original files during the closing actions (4-407e), after which all interim backup files should be deleted.

(4) The electronic files on the LAN X: drive are the official audit working papers; any copies of these files maintained on the auditor's hard drive or on LAN drives accessible by the FAO staff must be renamed or otherwise designated as back up or nonofficial copies.

(5) The auditor is responsible for populating the title, author, and keywords fields of the file properties in the audit report. File properties are only necessary for the audit report/memorandum and not for all other files contained within the APPS exe file.

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(6) The package is then exported, and notification is provided to the supervisory auditor/FAO manager for final review and completion of the associated audit report.

(7) Only four copies of the audit report should be retained in the official file, as follows:

- (a) Final, cross referenced draft in Microsoft Word
- (b) Final report ready for signature in Microsoft Word
- (c) Final report left unsigned and unsecured in PDF format
- (d) Final report, signed and secured in PDF format

(8) Printed copies of electronic working papers and the audit report are not required for inclusion in the package and should be rare. In cases where a determination has been made (and documented) to maintain hard copy when an electronic version is available, the hard copy included in the package must match the electronic version.

e. Closing Actions: The final closing actions should be completed as soon as possible after report issuance and, except for very unusual situations, within ten working days of report issuance. Each FAO must have written closing action procedures to ensure that appropriate Agency software is used to save and back up all final electronic working papers. The procedures should identify what types, if any, of electronic working papers will be made available for routine unofficial use and when they will be deleted, and should ensure the backup copy (copy stored on CD in the hard copy folder) is included with the working paper package when it is sent to storage. The procedures should also include the following elements.

(1) The Microsoft Word version of the draft audit report (containing all changes to the draft, except removal of the cross references and final spelling and format changes) must be cross-referenced (see 4-403j.(3) & 4-403k.) to the working papers and included in the working paper package. A table at the top of the cover sheet is provided for inserting supervisory approval. Previous versions of draft audit reports should not be retained in the current audit working paper file.

(2) The Microsoft Word version of the final audit report must be stored with the working papers. The APPS software generates a copy of the draft audit report for final processing. The copy created by APPS is named "01 DCAA Report [RORG-ASSIGNMENT NO.].doc". This file is processed to accept/reject tracked changes, remove the table at the top of the cover sheet, remove cross-references and comments, remove hyperlinks to other documents, and make final formatting changes. The electronic file should then be renamed to uniquely identify that file as the final report according to the convention "01 DCAA Report [RORG-ASSIGNMENT NO.]-Final.doc". For audits closed with documents other than reports, replace "Report" with the type of document issued (i.e., MFF, MFR, Letter, etc.) as appropriate for the draft and final. For supplements or revisions, add the designator –S1 or –R1 after the –Final designator, as

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appropriate.

(3) Once the final Microsoft Word report is ready for signature, the administrative staff will convert the Word document to PDF using Adobe Acrobat software. The administrative staff will then save the report in the PDF format and will name that report according to the convention "01 DCAA Report [RORG-ASSIGNMENT NO.]-Final-Unsigned.PDF". Once the unsigned report has been reviewed for formatting errors and is ready for signature, the administrative staff will save the report again in the PDF format and will name the second PDF report according to the convention "01 DCAA Report [RORG-ASSIGNMENT NO.]-Final-Signed.PDF". The version marked "Signed" will be the version that the FAO Manager will sign and secure. Only the signed and secured PDF version of the final report should be transmitted or otherwise used to support future actions related to this assignment.

(4) For reports sent to customers via e-mail, the transmission e-mail must be retained in the official files (see 10-203.9d for e-mail content). For audit packages, the transmission e-mail should be named "RORG-ASSIGNMENT NO-email.msg". The transmission e-mail should be included separately in the Livelink folder, as well as on the CD containing the APPS-generated executable file. To eliminate another copy of the report in the working paper package, the transmittal e-mail should be saved in a .msg format. For supplements or revisions, add the designator –S1 or –R1 after the – email designator as appropriate.

(5) The following copies of the final electronic working papers (which should include the APPS generated executable file, a separate uncompressed copy of the unsigned audit report in PDF format, a separate uncompressed copy of the signed and secured final audit report in PDF format, and the transmission e-mail) are required:

(a) The Official Working Paper Electronic Files (compressed as required, read-only, and self-extracting) will be stored in Livelink under the appropriate file code. A separate folder will be created for each assignment. Official copies of revised/supplemental working papers and revised/supplemental reports will be stored in the same Livelink folder as the original files. The file naming convention for the Official Working Paper Electronic Files is encoded by the Archive function in the APPS software using an 8-digit date format (e.g., 01701\_2003A10100001\_Archive\_20080927.zip). APPS does allow for a custom label at the end of the naming convention. Since the file name is already 40 characters long, this function should be used sparingly in conjunction with the archive function. However, the custom label function can and should be used for valid descriptors (e.g., cancelled) on archive files. It can also be used routinely to distinguish multiple copies of backups. For supplements, the designator S1 should be placed after the eight digit date. The S1 can be added using the custom label function.

(b) The FAO Backup Working Paper Electronic files will be stored on a single session CD in the hard copy folder. The backup copy of the electronic working paper files must be maintained as long as the original. This copy is to be used only if the original files in Livelink become lost or damaged. The naming convention for the

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backup copy should match exactly the Official copy.

(6) Any temporary files (recognized by the “~\$” or “~WRL” characters that begin the file name) and concatenated audit programs (working paper B-99) in the audit working paper package must be deleted during the closing actions. These files are duplicates which are used for recovery and review purposes. Saving them in the final audit working paper package could confuse personnel that use or review the work in the future.

(7) The following process shall be used to create the archive copies:

- The end user accesses the audit working paper files using APPS. This could be any member of the DCAA work force. It is critical that whoever is assigned this responsibility be appropriately trained, including training in APPS.
- Select the Utilities Function within APPS and use the Import Utility to import the selected assignment to the local machine.
- Use the Backup Utility to backup the file before proceeding. This file should be saved in a temporary location until the archive function is complete.
- Use the Export Utility Function (select “Archive” as the Type of Review) to export the selected assignment to the LAN X: drive. This will create the final official zip file (e.g., 01701\_2003A10100001\_Archive\_20093003.zip) that is stored.
- In Livelink and backed up in the hard copy audit folder on a CD. After the official file is created, complete (a), (b) and (c) below.

(a) Collect all the files created in the closing process (APPS generated zip file, a separate uncompressed copy of the final audit report, the transmission e-mail and the scanned signature page) in the assignment subdirectory on the X: drive.

(b) Follow the instructions in the Livelink User Guide to file all the appropriate official files in Livelink in a separate folder under the appropriate file code.

(c) Copy all files from the LAN X: drive to a temporary location on the C: drive to prepare for the CD burning process. Make a copy of the APPS generated zip file (\*.zip), final audit report file, transmission e-mail, and the scanned signature page file on a single session CD-ROM (type CD-R). Using the CD writing software, assure that the files are burned in the “Data CD” format, data is tested as it is recorded, and that the CD is closed at the end of the session. This will be the Backup Electronic File. After the electronic working paper backup copy is created, it must be opened and read to ensure it was not corrupted during the copying or compressing process. This test must be performed on another machine. Label the CD with, at a minimum, the following

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information:

- The word “tested” and the initials of the person who performed the test.
- The complete assignment number.
- A brief assignment description, such as:

Tested: XXX

2441-2004B21000001

Audit of XYX Proposal for Multicolored Widgets

(8) Ensure the backup electronic files (stored on single session CD-ROM’s) are securely enclosed in the working paper hard copy folder. The use of sleeves or other appropriate techniques should be employed to ensure the final electronic files are not separated or lost from the working paper package and the copies are kept in good condition. Each FAO should ensure strong controls are in place to protect the integrity of the official records/files as well as their physical security. The completed folder will then be stored consistent with standard FAO procedures.

(9) If the auditor receives or prepares supplemental documents/correspondence (e.g., price negotiation memorandum, documentation related to negotiations (15-404), attending a Board of Review (1-403.4), or circumstances described in 4-409) that are directly related to an assignment that has already been finalized, stored and archived, the auditor should use compression software when appropriate and create appropriately named files (e.g., “RORG-Assignment No.–PNM Data”). The new files should not be incorporated directly into the original APPS package. They should be filed in Livelink in the same folder with the original official files, but the original APPS files should not be opened to add the supplemental documentation. The new files should also be copied to a new single-session CD and stored with the backup CD for the original APPS files.

(10) Records discovered to be missing, lost, or destroyed prior to the date that they are eligible for destruction (and which cannot be recreated) must be reported in accordance with [DCAAM 5015.1](#), Chapter 4, paragraph C.

f. Sensitive Audits and Files: Most sensitive audits and files are closed using procedures provided in 4-407e and are archived in Livelink. Sensitive audits and files include, but are not limited to, classified work, suspected irregular conduct, hotline or [DCAA Form 2000](#). However, Rule 6e suspected irregular conduct (i.e., Grand Jury Criminal Investigations) and classified audits require special closing actions as follows:

(1) Rules 6e suspected irregular conduct working papers and files will not be filed in Livelink. Return the files and documents to the appropriate investigative agency.

(2) Audits related to classified work will not be filed in Livelink. Instead, the official and backup copy files will be stored on separate compact discs (CD/DVD). The

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archiving procedures provided in 4-407e(7) should be modified as necessary in recognition that sensitive files are not stored on an “X” drive and official/backup copies of the files are to be made. The file naming convention used in APPS for audit packages should be used in conjunction with a custom label for the “official” and “backup” copies. The official audit file name will include the custom label “\_Official”; and the backup file will include “\_Backup”. The custom label is added after the eight digit date (e.g. 01020\_20xxA10100001\_Archive\_YYYYMMDD\_Official.exe). APPS is used to create the official file. The backup file can be copied from the official file and the custom label in the backup audit file name be renamed from “\_Official” to “\_Backup”. Additional discussion of file naming convention is provided in 4-407e(5)(a). The Official electronic files must be stored in the hard copy folder. The Backup CD for classified audits must be stored separately from the Official Working Paper Electronic Files, in a controlled or locked file.

### **4-408 Computer-Aided Audit Applications \*\***

a. A computer-aided audit application is any audit task that has been automated using a software program. Any application that is developed must be tested before it is used. The extent and type of testing should be based on the complexity of the application and the inherent risk when relying on the results generated.

b. Audit applications done with a computer must fully satisfy the requirements of CAM 2-307 and 4-402b. Thus, working papers prepared with the aid of a computer should be documented in the same manner as those prepared manually. They should clearly describe the data and procedures employed in the computer application.

c. The amount of documentation will vary depending on the particular computer application employed; however, the data and procedures used in the application must be sufficiently documented and properly retained to satisfy the requirements of 4-402b and to facilitate the re-creation of the application. Examples of matters that may need to be documented to fully explain the computer-aided audit work are:

(1) the basis for formulas used in spreadsheet-type applications or in calculated columns of tabular schedules,

(2) detailed schedules supporting summary schedules, and

(3) the input data if it is not shown in the output.

Depending on the application, the required documentation may be in the form of supplementary printouts from the computer application program or explanatory annotations by the auditor.

d. Proper training, planning, and testing are important factors in ensuring that computers are effectively used and in minimizing the risk of generating inaccurate results. However, just learning about proper design methods and good construction techniques in developing an audit application provides no guarantee that the results will be error-free. Adequate control features need to be identified, designed, and

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incorporated into the documentation, data entry, processing, and output portions of an audit application. For example, the following control activities could be used for spreadsheet applications, where appropriate:

- (1) Retain a listing of the formulas and their relationships.
- (2) Attach instructions and identification data with the spreadsheet application.
- (3) Create back up files.
- (4) Use the software protection/locking features to protect formulas and overall structure.
- (5) Use record counts, data totals, hash totals, or other control totals.
- (6) Calculate key balances using two alternative methods and then compare the results to make sure they are equal.
- (7) Use range and reasonableness check numbers to confirm totals.
- (8) Run test data and review the output for accuracy.

e. Store the data supporting a computer-aided audit application on reliable computer media (i.e., single session CD-ROM, magnetic tape, etc.) labeled with the appropriate audit assignment number. Take necessary precautions to adequately store and protect the electronic files.

f. Auditors should not create electronic files that are so large that they are difficult to store, e-mail, or otherwise handle. When scanning or otherwise obtaining electronic files, the auditor should obtain and retain only necessary data, and should properly prepare audit reports and working papers. When it is necessary to retain electronic copies of contractor data or documents (see 4-406), it should be in an efficient format. Pages scanned in accordance with Agency guidance will usually be less than 100 kilobytes in file size; however, if the settings are incorrect, a single page can take up several megabytes (e.g., when saved as a .BMP file rather than a .PDF file). A document saved in an .RTF format can be several times larger than the same document saved in a .DOC format. All overly large files should be reviewed to ensure they are in the most efficient format and do not contain unnecessary images or data. Significant amounts of data can be embedded or imported into a document or spreadsheet without realizing the significant impact on file size. Images may be pasted into a document as a .BMP file which can make the document very large, but which may not be easily identified because they are embedded in the document and the auditor cannot see the portions that are in the .BMP format. Similarly, Excel workbooks shall not be embedded into audit reports (see CAM 10-203.14), although that process can be used in working papers. When issuing audit reports, a good rule of thumb is that the file size should be about 50 to 100 kilobytes per page. If the report is significantly larger, it should be checked. There is a File Size Review Tool available on the DCAA Intranet to assist auditors and supervisors in identifying files with size problems. Regional RSA staff can

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provide assistance if needed.

g. Supervisory review to ensure compliance with the auditing standards applies to computer-aided audit applications, just as it applies to any other type audit application. The reviewer must evaluate each application based upon its objectives and the relative sensitivity of the audit conclusions.

### **4-409 Documentation of Differences of Opinion on Audit Issues\*\***

[GAGAS Appendix 1, paragraph A3.10b\(6\)](#) requires audit organizations to maintain “procedures for resolving difficult or contentious issues or disagreements among team members, including specialists”. Examples of differences of opinion on audit issues may include disagreements on the audit opinion, the sufficiency and/or appropriateness of audit evidence, or the nature and extent of audit procedures necessary to meet the audit objectives.

(a) Due to the complex nature of our work, it is not uncommon for differences of opinion on audit issues to arise between two or more members of the team during the performance of an audit. In most instances, the audit team can resolve the difference of opinion through discussion of the issue and should strive to do so at the lowest level possible. When differences of opinion occur, it is imperative that the team act in a manner which reflects our core values of teamwork and mutual respect. The audit team should make every effort to reconcile differences of opinion on audit issues before issuing the audit report. If any members of the audit team (auditors, technical specialist, FAQ, supervisor, FAO Manager, RAM) involved in the performance of the audit disagree with other members of the audit team on a significant audit issue, the audit team should meet to discuss and attempt to resolve the issues. Since effective communication is essential to resolving differences of opinion, as an issue is elevated, the discussions should include all parties involved.

(b) If the audit team members involved cannot resolve the difference of opinion, the issue should be elevated to the next highest level of management. It is the responsibility of the highest level audit team member involved in the disagreement to elevate the issues to the next highest level. For example, if an auditor and his/her supervisory auditor have a difference of opinion, the supervisor is responsible for elevating the audit issue to the FAO manager. Prior to elevating the issue to the RAM, the FAO should prepare a brief summary of the difference of opinion and be prepared to discuss the issues in detail. If the RAM is unable to reconcile the difference of opinion, he/she is responsible for elevating the issues to the Deputy Regional Director. If the Deputy Regional Director is unable to reconcile the difference of opinion, he/she will make a final decision.

(c) If the disagreement is not resolved to the satisfaction of an audit team member, they may, at their discretion, write a dissenting opinion and place the documentation in the “Documentation of Audit Disagreements” folder generated by APPS. The documentation should include the specific basis and facts for the disagreement. Additionally, if the unreconciled difference of opinion results in differing questioned,



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unsupported, or unresolved costs, the documentation should include information of the dollar impact. Documentation is generally only required when the difference of opinion could significantly or materially affect the audit conclusions. As auditing standards require the audit report be fully supported by the working papers, the final working papers must represent the final conclusions reached as contained in the audit report.

(d) The name of the audit team member who has documented an unreconciled difference of opinion may be excluded from the “DCAA Personnel” section of the applicable audit report if the member so chooses. The audit team must follow the guidance above for unreconciled differences of opinion on significant audit issues even if an assignment is subsequently cancelled.

### **4-410 Supplemental Revisions to the Audit Working Papers after the Audit Report is Issued\*\***

a. Audit documentation in the official files must not be altered, deleted or discarded after the report issuance date. This includes the original official electronic APPS package; the files on the backup CD, and hard copy working paper files. However, circumstances may require additions to audit documentation after the report release date. In all cases, the original file must be left intact (see 4-410b). Under the AICPA auditing standards, additional audit procedures and supplemental working papers may be necessary after audit report issuance when, subsequent to the date of the audit report:

(1) The auditor concludes that one or more procedures considered necessary at the time of the audit, in the circumstances then existing, were omitted.

(2) The auditor becomes aware that additional facts regarding the subject of audit may have existed at the report date, and such facts might have affected the report.

(3) Relevant and material developments or events have occurred (e.g., final determinations or resolutions of contingencies or other matters disclosed in the audit report or which had resulted in a departure from the auditor's standard report). See CAM 10-213.1 for guidance on supplemental audit reports in this situation.

The auditor should supplement working papers and issue a supplemental report only when necessary under circumstances 1 through 3 listed above, or if a supplemental report would be useful to the requestor or other likely report users. For example, the audit issues are still outstanding/being negotiated or there is a possibility that the audit may be used to settle disputes. When working papers are supplemented, they should contain a concise explanation of the circumstances, and resolution of the issues involved. Guidance on supplemental audit reports is contained in CAM 10-213.

b. When additional audit procedures and/or supplemental working papers are needed after the audit report has been issued due to application of previously omitted procedures, additional facts, or to address subsequent events, the supplemental working papers should be created as a separate set of files and electronic files should be stored following the procedures in 4-407e(9). If there are hard copy working papers for the

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assignment, care must be taken to ensure that the original set which existed at report issuance/assignment closure are not altered in any manner. The auditor should take prudent measures to ensure that the supplemental working papers will not be mistaken for part of the original official working paper package. Supplemental working papers should contain a concise explanation of the circumstance under which they were created. The auditor should ensure that the supplemental working papers:

- are clearly distinguished from the original content;
- fully document the circumstances leading to the additional effort;
- contain a lead schedule summarizing the cost elements/areas evaluated;
- contain structured notes or on-page notes as appropriate (see 4-403.g); and
- properly reflect who performed the additional procedures and the dates that the additional procedures were performed. Working papers must meet Agency documentation standards discussed in 4-403.

The Supplemental W/P A and the supplemental lead schedules for the changed cost elements/areas evaluated should be annotated with the updated recommendations/conclusions, if any, and cross-referenced to the working papers supporting the update. Supplemental working papers will be separate from the documentation in the original audit files.

### c. Consideration of Omitted Procedures After the Report Date

Additional audit procedures are necessary when an auditor concludes that a procedure considered necessary at the time of the audit in the circumstances then existing was omitted

(1) The auditor should assess the importance of the omitted procedure to his/her present ability to support the previously expressed opinion or conclusions regarding the audit taken as a whole. The following procedures may be helpful in making an assessment of the importance of the omitted audit procedures:

- review the working papers;
- discuss the circumstances with the personnel involved in the audit (i.e., supervisory auditor, requestor, contracting officer), and others; and
- reevaluate the overall scope of the audit. For example, the results of other procedures that were applied may tend to compensate for the procedure omitted or make its omission less important. Also, subsequent audits may provide audit evidence in support of the previously expressed opinion.

(2) If the auditor concludes that the omission of a procedure considered necessary at the time of the audit report in the circumstances then existing:

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- impairs his/her present ability to support the previously expressed opinion or conclusions regarding the audit, and
- the auditor believes there are persons currently relying, or likely to rely, on the report, the auditor should promptly undertake to apply the omitted procedure or alternative procedures that would provide a satisfactory basis for the opinion or conclusions.

(3) If the previously omitted procedure or alternative procedures cannot be applied, the auditor should discuss this matter with the supervisor and/or FAO manager to determine an appropriate course of action concerning responsibilities to the requestor, contracting activities, or other individuals who may rely on the report.

(4) If the additional procedures disclose that the report opinion, conclusions, or recommendations must be updated, follow the reporting guidance in CAM 10-213. If no report revision is necessary, annotate the working papers to explain why this is the case.

### d. Subsequent Discovery of Information Affecting the Audit Report Results

(1) If, subsequent to issuance of an audit report, the auditor becomes aware of facts or events that would have been evaluated during the course of the audit, had they been known at the time, the auditor should promptly:

- undertake to determine whether the information is reliable, and
- assess whether its impact may be material.

Information at issue may have come into existence either before or after the audit report date. In any case, the auditor should discuss the matter with the contractor at any management level deemed appropriate, and request cooperation in whatever evaluation may be necessary.

(2) When the subsequently discovered information is found to be reliable, the auditor should take action in accordance with the procedures described in the subsequent paragraphs if the nature and effect of the matter are such that:

(a) the report would have been affected if the information had been known at the date of the report and had not been reflected in the audit; and

(b) the auditor believes there are persons currently relying or likely to rely on the audit report who would attach importance to the information.

Consideration should be given, among other things, to the time elapsed since the audit report was issued. When the auditor has concluded, after considering (a) and (b) above, that action should be taken to amend the opinion, conclusions, or recommendations in the original report, a supplemental report should be issued in accordance with CAM 10-213.

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(3) If the effect on the audit report of the subsequently discovered information cannot be determined without a prolonged evaluation, the issuance of a supplemental audit report will necessarily be delayed. When it appears that the information will require a supplemental report, appropriate disclosure would consist of notification to the requestor and any other persons who are likely to rely on the audit report that supplemental work is being performed and a supplemental report will be issued upon completion of the evaluation.

### **4-500 Section 5 - Using Information Technology (IT) in Contract Auditing \*\***

#### **4-501 Introduction \*\***

a. This section describes how IT can assist in audit of contract costs being estimated and/or incurred by contractors (to include internal control audits), and ways available to obtain related audit assistance. It includes policy and procedural guidelines for using both DCAA and non-DCAA IT resources for technical audit applications.

b. CAM sections 5-400 and 5-1400, along with the Information Systems (IS) Auditing Knowledge Base, available on DCAA's Intranet, include general background and orientation material on IT, Information Systems (IS), and related terminology. More specific guidance on contract audit objectives related to IS includes:

- (1) Evaluating IS General Internal Controls (CAM 5-400).
- (2) Evaluating IS Application Internal Controls (CAM 5-1400).
- (3) Auditing the economy and efficiency of contractor IT operations (C-400).

#### **4-502 Policy on Use of IT \*\***

##### **4-502.1 General Criteria for Using IT in Audit Applications \*\***

a. Auditors are capable of performing many audit tasks using IT, and DCAA strives to take full advantage of this capability. The growing cost and scarcity of auditor time, coupled with increasing economy and efficiency of IT, can make the choice of using it increasingly cost-effective.

b. IT resources available to DCAA auditors include any computer system and software from:

- (1) the contractor that has submitted the data,
- (2) DCAA regional and field audit offices, and
- (3) the Technical Support Branch (OTST) of the Technical Audit Services Division in Memphis, TN.

If the data is written or copied to any electronic media, it can be accessed by

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any one of a number of data manipulation software tools. Due to the transportability of data, processing can take place at the contractor site or at any other processing site available to DCAA. Assistance in requesting and obtaining contractor data is available from regional and OTST computer specialists.

c. Documents used to enter information into the computer for processing, certain computer files, or other evidential matter required by the auditor may exist only for a short period or only in electronic form. In some computer systems, input documents may not exist at all because information is directly entered into the system. A contractor's data retention policies may require the auditor to request retention of some information for his/her evaluation or to perform audit procedures when the information is available. In addition, certain information generated by the computer for management's internal purposes may be useful in performing analytical tests (e.g., system management facilities and statistical analysis system data).

d. Using IT may also provide an opportunity to apply certain procedures to an entire population of accounts or transactions rather than performing sampling. In addition, in some accounting systems, it may be difficult or impossible for the auditor to analyze certain data or test specific control activities without using IT resources.

e. When performing an audit, the auditor should employ an appropriate combination of both manual and IT related audit techniques. In determining whether to use IT, the auditor should consider such factors as:

- (1) the auditor's expertise, knowledge and experience with IT,
- (2) the availability of suitable IT resources,
- (3) the efficiency and effectiveness of using IT related techniques over manual ones,
- (4) time constraints,
- (5) integrity of the contractor's information system and IT environment, and
- (6) level of audit risk.

f. Certain planning steps should be taken in preparing for the application of selected IT related audit techniques such as:

- (1) setting objectives for using IT,
- (2) determining the accessibility and availability of IT resources and data,
- (3) defining the procedures to be taken (e.g., statistical sampling, recalculation, confirmation, etc.),
- (4) defining output requirements,

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(5) determining resource requirements, and

(6) documentation of IT used including objectives, high-level flowcharts, and any operating instructions.

g. Data files, such as detailed transaction files, are often retained for only a short period of time; therefore, the auditor should make arrangements for the retention of the data covering the appropriate audit time frame. If the auditor plans to access the contractor's IT resources and data, arrangements should be made well in advance of the needed time period in order to minimize the effect on the contractor's IT environment. The auditor should also assess the effect that any changes to the IT environment may have on the use of IT in any audit applications. In doing so, the auditor should consider the effect of these changes on the integrity and usefulness of IT, as well as the integrity of any data used.

h. The auditor should obtain reasonable assurance of the integrity, reliability, usefulness, and security of IT through appropriate planning, design, testing, processing and evaluation of documentation. This should be done before reliance is placed upon the IT. The nature, timing and extent of testing is dependent on the availability and stability of any IT resources used.

i. The use of IT should be controlled to provide reasonable assurance that the audit objectives and the detailed specifications of the IT related audit activity have been met. Certain tests should be performed such as:

(1) a reconciliation of control totals,

(2) a review of output for reasonableness,

(3) a review of the logic, parameters or other characteristics of the IT, and

(4) a review of the contractor's IT general controls which may contribute to the integrity of the IT (e.g., program change controls and access to system, program, and/or data files) before the auditor relies upon system outputs.

j. Use of IT for audit applications should be sufficiently documented to provide adequate audit evidence. Specifically, workpapers should include a description of the IT related audit activity, its planning and execution, and any output produced along with conclusions reached.

### **4-502.2 Use of Contractor IT \*\***

a. With some computerized applications, access to contractor IT and data may be clearly essential for proper audit of costs incurred or proposed.

b. When possible, meet audit needs through adjustments to normally scheduled contractor computer runs rather than by special runs solely for contract audit purposes. Consider using reports or other records that are otherwise available before requesting

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special reports. This requires knowledge of the usefulness of available contractor output. Be receptive to suggestions of the contractor's personnel, so long as audit objectives are achieved effectively and efficiently.

c. In many applications the value of the audit benefit received will far exceed the net cost to the contractor. Often, added IT costs are more than justified by benefits accruing to the contractor, such as accelerated cash flow resulting from timely processing of progress payment requests or public vouchers, greater assurance of the accuracy of records, and reduced administrative support to contract audit requirements. Sample selections, cost reconciliations, and special analyses requested by the auditor often save the contractor other significant audit support efforts; and the audit data can often be used by the contractor's operating personnel to improve performance of their assigned tasks.

### **4-502.3 Cooperation with Internal and Independent Auditors \*\***

Obtaining cooperation from the contractor's internal audit staff and/or independent auditors can facilitate the use of IT in auditing contract costs. These groups normally perform reviews of the company's IS and the data processed. They may often be aware of computer listings and/or general purpose computer programs within the system which will provide the specific information needed by the auditor. Obtain and use this assistance following the guidelines in 4-202 and 4-1000.

### **4-503 Organizational Support of Auditing Using IT \*\***

DCAA maintains a complete network of regional and Headquarters resources to help the field auditor determine the feasibility of using IT resources for audit applications and implementing those that are appropriate. (These resources are, for the most part, the same as are available to assist the field auditor plan and/or perform the types of audits noted in 4-501b.)

#### **4-503.1 Regional IS Auditors and Computer Specialists \*\***

One or more auditors in the regional special programs offices are responsible for coordinating the overall implementation of auditing using IT policy and programs within the regions. These auditors provide technical guidance and assistance in performing audits using IT resources.

#### **4-503.2 Technical Support Branch \*\***

a. OTST provides guidance and assistance for audit applications using IT resources. In addition, OTST is responsible for coordination and control of computer program development to ensure adequate dissemination of new and/or refined IT audit techniques

b. OTST provides technical guidance, support, and assistance for all aspects of audit applications using IT including internal control evaluations, information access, retrieval, displaying, and reporting; capacity planning; computer performance evaluation; and system tuning. OTST also provides direction and assistance in using

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generalized data management and data manipulation software packages (both commercially available and OTST developed) such as SAS, FOCUS, SQL, MSAccess, and VisualBasic.

c. OTST provides guidance and assistance involving statistical sampling, correlation analysis, and improvement curves (EZ-Quant); use of economic data; Flexible Progress Payments; and the computations used to determine if a lease should be classified as an operating lease or a capital lease in accordance with GAAP. In addition OTST provides onsite and written directions for complex applications of statistical sampling (Variable and Attribute Sampling Guidebooks), correlation analysis (Graphic & Regression Analysis Guidebook), and improvement curves (Improvement Curve Analysis Guidebook).

### **4-503.3 IT Related Training \*\***

DCAA's general auditor training and career development plan includes courses designed to provide a basic understanding of Information Systems and Information Technology and the audit concerns associated with this environment. The courses are offered through the Defense Contract Audit Institute (DCAI) and conducted by OTST. More specialized courses, offered through both Government and non-government sources, are available on an as-required basis.

### **4-504 IT Audit Tools \*\***

#### **4-504.1 Generalized Audit Software \*\***

Generalized audit software is a computer program or series of programs designed to perform certain automated functions. These functions include reading computer files, selecting data, manipulating data, sorting data, summarizing data, performing calculations, selecting samples, and printing reports or letters in a format specified by the auditor. This technique includes software acquired or written for audit purposes and software embedded in information systems. When using generalized audit software, the auditor should take appropriate steps to protect the integrity of the contractor's data.

#### **4-504.2 Application Software Tracing and Mapping \*\***

Application software tracing and mapping is the technique of using specialized tools to analyze the flow of data through the processing logic of the application software and document the logic, paths, control conditions, and processing sequences. Both the command language or job control statements and programming language can be analyzed. This technique includes program/system: mapping, tracing, snapshots, parallel simulations, and code comparisons. When using application software tracing and mapping, the auditor should confirm that the source code being evaluated generated the object program currently being used in production. The auditor should be aware that application software tracing and mapping only points out the potential for erroneous processing; it does not evaluate actual data.

#### **4-504.3 Audit Expert Systems \*\***



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Audit expert systems or decision support systems are tools that can be used to assist auditors in the decision-making process by automating the knowledge of experts in the field. This technique includes automated risk analysis, system software, and control objectives software packages. When using audit expert systems, the auditor should be thoroughly knowledgeable of the operations of the system to confirm that the decision paths followed are appropriate to the given audit environment/situation.

### **4-504.4 Test Data [\\*\\*](#)**

Test data are simulated transactions that can be used to test processing logic, computations and controls actually programmed in computer applications. Individual programs or an entire system can be tested. This technique includes Integrated Test Facilities (ITFs) and Base Case System Evaluations (BCSEs). When using test data, the auditor should be aware that test data only point out the potential for erroneous processing; this technique does not evaluate actual data. The auditor also should be aware that test data analysis can be extremely complex and time consuming, depending on the number of transactions processed, the number of programs tested, and the complexity of the programs/system. Before using test data the auditor should verify that the test data will not affect the contractor's live system.

### **4-504.5 Utility Software [\\*\\*](#)**

Utility software is a computer program often provided by a computer hardware manufacturer or software vendor and used to support running the system. This technique can be used to examine processing activity; test programs, system activities, and operational procedures; evaluate data file activity; and analyze job accounting data. When using utility software, the auditor should confirm that no unplanned interventions have taken place during processing and that the utility software has been obtained from the appropriate system library. The auditor should also take appropriate steps to protect the integrity of the organization's system and files since these utilities can easily damage them.

## **4-600 Section 6 - Audit Sampling and Other Analytical Procedures [\\*\\*](#)**

### **4-601 Introduction [\\*\\*](#)**

Auditors should make optimum use of all audit techniques which will increase the efficiency and effectiveness of the audit. The appropriate use of audit sampling and other analytical procedures will assist the auditor in reaching this goal. Audit sampling includes both statistical and nonstatistical sampling. Other analytical procedures include the use of correlation, regression and improvement curve analysis. The use of these techniques help to ensure the effective use of resources while improving audit quality. These techniques are further optimized when data is obtained in electronic format from the contractor to facilitate the use of the Agency developed EZ-Quant software.

### **4-602 Audit Sampling [\\*\\*](#)**

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This section provides guidance for planning, performing, and evaluating audit samples.

### **4-602.1 Selection Methods That Are Not Sampling – Judgmental Selection**

**\*\***

Auditors employ multiple selection methods to assist in obtaining sufficient and appropriate audit evidence. However, many of these methods are not sampling by definition. For clarification, certain common selection methods which do not meet the definition of audit sampling include:

- (1) selection of 100 percent of the items within a population,
- (2) selection of all items within a population which have a particular characteristic (for example, all items over a certain dollar amount – high dollar items only or specific sensitive transactions such as Executive Airfare in a G&A travel account), or
- (3) a decision not to select any items (i.e., no auditing procedures applied due to low risk or immateriality of items).

Since the items were not selected on a basis that was expected to be representative of the population, and the audit objective was not to draw an inference on the population as a whole; these are not sampling applications. These techniques are nonsampling procedures; reflecting nonrepresentative selections. DCAA uses the terms "Judgmental Selection" to classify this type of selection method. Judgmental selection of items for audit examination may be a viable alternative to sampling, especially when dealing with a small universe, or where a small number of transactions represent a significant portion of the universe value. The judgmental selection findings only apply to the specific items selected for examination and must not be projected to the portion of the universe not tested. This is a key distinction between sampling versus judgmental selection. Judgmental selection may be used to gain an understanding of the types of transactions in an account, determine the types or quantities of errors as an initial risk assessment tool, help to gain a sufficient understanding of an account to develop a sampling plan, or to render an opinion on the account balance if the selection result in adequate audit coverage of the universe to meet the audit objectives. See 4-403 g. (4) for guidance addressing required working paper documentation for a judgmental selection.

### **4-602.2 Sampling **\*\*****

a. [The Statement on Auditing Standards \(SAS\) No. 39, Audit Sampling \(AICPA, Professional Standards, vol. 1, AU sec. 350\)](#), states that audit sampling is “the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class”. Simply stated, audit sampling involves examining less than the entire body of data to express a conclusion about the entire body of data.

b. Sampling represents an important tool for the auditor to gain information and

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to draw a conclusion about the population without the need to examine the population in its entirety. A key expectation is that the sample items reviewed will be representative of the population taken as a whole (i.e., reflect the same characteristics that occur in the population). Sampling is used by the auditor to obtain sufficient appropriate evidential matter and is performed because it is generally more efficient than testing 100 percent of a population. Some important advantages of audit sampling include:

- (1) saves audit time,
  - (2) more effective and efficient way of auditing large complex populations,
- and
- (3) meets the audit objective and can provide defensible audit results.

### **4-602.3 Statistical and Nonstatistical Sampling\*\***

a. Auditors can use statistical or nonstatistical sampling in their audits. The method selected depends on which is the most effective means of satisfying the audit objective and supporting favorable resolution of any reported conditions. Statistical sampling is preferred because of its advantages, which include:

- (1) Sample selection is objective and thereby defensible,
- (2) Sample results can be projected to the universe,
- (3) Sample may provide better coverage with less audit effort, and
- (4) Sampling results provide for a statistical measurement of sampling reliability and/or sampling error (precision at a particular confidence level).

b. The requirements for a statistical sample include a random sample selection and the use of probability theory to both evaluate sample results and measure sampling risk. A randomly selected sample is one in which each item in a stratum has a known probability of being selected. More broadly, a statistical sample is one for which each sampling unit within a stratum has a known and equal chance for selection. The manner of selection of the items must preclude any personal influence as to which items are included in the sample.

c. Sample reliability and accuracy cannot be statistically evaluated in a nonstatistical sample (i.e., precision at a particular confidence level cannot be mathematically computed in a nonstatistical sampling application). A nonstatistical sample may be selected using a random selection technique, a haphazard approach, or using most any other approach provided the sample items are selected in a way the auditor expects to be representative of the population, and all items in the population should have an opportunity to be selected. Since sample reliability and accuracy (precision at a particular confidence level) cannot be statistically measured in a nonstatistical sampling application, sample sizes should be at least 25 percent larger than sample sizes for statistical sampling applications. Without application of statistical

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concepts, there is greater risk a nonstatistical sample will not be representative of the universe (i.e., reflect the same characteristics that occur in the universe such as similar questioned ratios); therefore, at least a 25 percent increase in sample size is necessary in order to subjectively draw conclusions. Increasing the sample size by at least 25 percent provides greater assurance the sample results will be representative of the universe.

Nonstatistical sampling must not be used to make monetary projections of sample results to the sample universe, i.e., to determine projected questioned cost. Nonstatistical sampling may be appropriate when used to make an audit judgment or conclusion when testing a nonmonetary characteristic. By policy, DCAA audits will not use nonstatistical sample results to extrapolate sample results into monetary projections of the sample population.

### **4-602.4 Scope and Degree of Testing \*\***

a. The scope and degree of testing is a matter of professional judgment by the auditor. The decision will be influenced by prior experience, materiality, sensitivity, and other factors, including recognition that only a statistical sample can be defended as truly objective. Application of audit sampling recognizes that a complete review of all the transactions which support a proposal, claim, or other form of financial representation generally is unnecessary or impractical. It is possible to support a professional opinion regarding a contractor's representation by reviewing transactions on a sampling basis. Review of all representations may be required when a few transactions or items of large amounts are involved or when it is necessary to develop detailed information devoid of sampling error, such as in the case of support for legal action.

b. In selecting the items to be tested, and in determining the extent of the examination, the auditor must have an understanding of the control or account to be tested. To obtain this level of understanding, the auditor may need to conduct a preliminary nonstatistical procedure of only a few items to gain an understanding of the transaction(s) or process flow, controls applied, and types of supporting documentation available. In addition, it is important to profile the account transaction detail to gain an understanding of the type of transactions it contains; both in characteristics as well as transaction dollar values. (For example, the account may include credits, accruals, reversals, and zero dollar items.) The following guidelines should be considered:

(1) Examination of all large transactions (the meaning of "large" will vary; thus, a \$1,000 item in a \$10,000 claim would deserve attention, but the same item would not be "large" in a \$10 million indirect cost pool in which the Government shares a small percentage).

(2) Review of all transactions of an unusual or sensitive nature.

(3) More extensive tests in areas where procedures or internal controls are known to be weak or where deficiencies were disclosed in previous audits, where errors or items of a questionable nature are more likely to occur in certain departments or in

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records produced by certain categories of employees, during certain periods of reorganization, or where personnel are assigned unfamiliar tasks.

- (4) Lapse of time since previous tests.
- (5) Special attention to those areas where incorrect charges would have the greatest effect on the costs to the Government.
- (6) Trend information from previous audits.
- (7) Testing of other transactions where the total amount may be significant in the aggregate

c. There exists an interdependence of audit sampling and the other audit techniques that serve as sources of reliance for audit conclusions and recommendations. Seldom is an audit recommendation based solely on the evaluation of the sample only. In the examination of contract costs, the auditor's objective is to report an informed opinion on the propriety of the contractor's cost representations. In expressing an opinion, the auditor does not require complete certainty (which may not be practical to obtain) regarding the contractor's representations. The auditor only needs reasonable assurance that the audit conclusions are substantially correct. An understanding of this relationship is essential to the effective application of audit sampling to contract auditing. It is this relationship and understanding that guides the auditor's judgment in formulating an effective sampling plan that meets the audit objective.

### **4-602.5 Use of Information Technology to Assist in Sample Selection \*\***

a. DCAA has available a number of automated tools to assist auditors in statistical and nonstatistical sampling as part of the EZ-Quant application. EZ-Quant is a collection of quantitative methods for which Agency developed software has been written to perform quantitative analyses such as statistical sampling, regression analysis, and improvement curves. EZ-Quant applications will be used by auditors for both attributes and variables sampling applications.

b. The EZ-Quant software has been designed to operate directly with data files created by MS Excel, MS Access, and simple text data files. In addition, EZ-Quant features assist the auditor in preparing and documenting procedures applied into standard audit workpapers. Auditors should not use other sampling software applications. The use of EZ-Quant applications is paired with the expectation that auditors take full advantage of contractor automated systems and electronic files.

### **4-602.6 Sampling Applications \*\***

a. The sampling procedures applied will be controlled by the audit objective. Audit sampling can be used to conduct compliance tests to determine whether certain controls or procedures are complied with, or substantive tests to determine an amount or value of an account. This is sometimes referred to as a dual purpose test.

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b. Generally, the auditor will use attributes sampling for compliance testing and variables sampling techniques to conduct substantive testing. These two sampling techniques are further distinguished as either acceptance or sampling for substantive tests of details. The purpose of acceptance is simply to either accept or reject a statement of condition, whereas sampling for substantive tests of details provides an answer to the question of either how many or how much.

### **4-602.7 Attributes Sampling \*\***

Attributes sampling is performed when there are only two possible outcomes from the evaluation of a sample item: the sampled attribute(s) either is or is not in compliance with the law, regulation, or internal control being tested. An attribute test is built around questions answerable by either "yes" or "no". Each attribute is tested separately and error rates are evaluated separately for each attribute. Attributes sampling can be classified into the two approaches of acceptance and estimation sampling. Their use depends on audit objectives. With acceptance sampling, the goal is usually to either accept or reject the universe. With estimation sampling, the goal is to estimate the actual error rate in the universe.

a. Attributes acceptance sampling is typically used for evaluating a contractor's internal controls. This includes the evaluation of policies, procedures, and practices to determine the adequacy of internal controls or operational efficiency. Since perfection is seldom expected, there is some level of noncompliance that can be tolerated without altering the planned, assessed level of control risk. Attributes acceptance sampling is designed to discern whether noncompliance is within tolerable limits. In acceptance sampling, the minimum sample size can be determined to distinguish between tolerable and intolerable conditions. The tolerable level of noncompliance or critical error rate is specified in advance and documented in the sample plan. Acceptance sampling is not designed to estimate questioned costs. Instead, poor compliance revealed by an acceptance sample would normally prompt recommendations for system changes. Examples of acceptance sampling applications include discovery sampling, acceptance one step sampling, and acceptance two step sampling.

b. An attributes estimation sample is designed to estimate the frequency of a specific type of error in a universe. A sample size is determined that provides a desired level of assurance (or confidence) that the error rate is estimated with a desired degree of precision. In contrast with acceptance sampling, estimation sampling is designed to estimate the noncompliance rate with a level of precision specified by the auditor. Attributes estimation sampling is generally applicable to audits where compliance of the universe is being estimated as opposed to being subject to a pass/fail test. Estimation sampling is appropriate when the audit objective is to estimate an adjustment (impact) based on a statement of error conditions.

### **4-602.8 Variables Sampling \*\***

a. Variables Sampling is generally used to verify account balances of cost elements and estimate any differences between the contractor's claimed or proposed amounts and those supported by the audit evaluation. The audit sample universe (e.g.,

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accounts, vouchers, or bill of material) represents the entire grouping of items from which a sample will be drawn. Examples where variables sampling can be applied to proposals, incurred costs, progress payments, forward pricing rates, and defective pricing.

b. An important objective of variables sampling is to estimate a particular universe characteristic such as total unallowable costs (or questioned cost). The estimated questioned cost is commonly known as the “point estimate”. A point estimate strikes a balance between potential understatement (considering both likelihood and amount) and potential overstatement of the true universe amount. In statistical sampling, “confidence level” and “precision” are used to measure the reliability and accuracy of the point estimate. The confidence level deals with “sureness” (or assurance) while precision deals with “closeness” (or accuracy). All initial statistical sampling evaluations will be performed using at least a 90 percent confidence level. As explained in 4-602.9b, auditors may consider evaluating the sample using a lower confidence level such as 80 or 85 percent if the level of control risk and/or inherent risk supports this or other procedures were performed which support the sample results.

c. Statistical sampling for variables can be performed in two ways, depending on selection probabilities for individual sampling units. These are Physical Unit Sampling (PUS) and Dollar Unit Sampling (DUS). With physical unit sampling, each item (physical unit) in the sample universe has an equal chance of being selected. Physical unit sampling is often referred to as classical variables sampling. Dollar Unit Sampling also known as Monetary Unit Sampling, uses probability proportional to size sampling (PPS), in which each item has a selection probability that is proportional to its dollar (absolute value) size. This translates to an equal chance of selection for each dollar in the sample universe.

(1) In physical unit sampling, sample items (invoices, timecards, travel vouchers, etc) can be selected either manually or by using EZ-Quant. In applications of physical unit sampling, the auditor will commonly employ stratification to enhance sampling reliability and accuracy. A statistical sample requires that sampling units within a stratum be randomly selected and all units within the stratum should have an equal chance for selection. The auditor then evaluates the sample items and determines any cost that should be questioned. Stratification is decided as part of the sample plan and while it is usually based on dollar value it may also use other characteristics.

(a) Data stratification for audit purposes is the partitioning of the sample universe into smaller groups according to a scheme that suits audit purposes. Stratification does not change the audit universe, but merely breaks it down for sampling and then combines the results. Stratification is primarily used in variables sampling, and is rarely used in attributes sampling.

(b) The usual purpose of stratification in contract audit sampling is to improve sampling precision. The most common single basis for stratification in contract audit sampling is the recorded dollar amount of the individual universe items. Other

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bases for stratification are possible, either instead of or in conjunction with dollar based stratification. In many situations, the auditor may believe that other characteristics of the universe items significantly affect the probability or amounts of errors. For example, unallowable costs may be more frequently encountered in vouchers that relate to certain types of transactions, departments, or payees.

(2) Dollar unit sampling is a substitute for stratification by dollar amount. Its selection probability proportional to size (PPS) feature concentrates the sampling evaluation toward larger items much the same as stratification does for physical unit sampling. DUS does have an advantage over PUS in dealing with selected items that prove to be clusters of smaller physical units. Dollar interval selection is used to select DUS samples. An interval is determined, and items with an absolute value exceeding the interval are automatically selected for evaluation and removed from the sample universe. The remaining items comprise a single sampling stratum. A starting value less than the interval is randomly determined. It becomes the first "dollar hit". Subsequent hits are determined by adding the value of the sampling interval to the prior dollar hit until the process has stepped through the entire sampling stratum. The sample items are those containing the dollar hits. DUS is not suitable to sample for understatements or items with zero dollar value. With DUS, universe items with understated values may not have an equitable selection probability, and zero value items will not be selected in the sample. If the point estimate is not reported due to an inadequate precision value, an additional advantage of DUS is generally a greater proportion of the sampling universe dollars are examined because of the tendency to select higher dollar items for examination.

### **4-602.9 Sampling Plan Design and Documentation \*\***

The successful audit application of sampling begins with the design of the sampling plan. Sampling plans are required for audit applications of both attributes sampling and variables sampling. Both statistical and nonstatistical sampling applications require a well- documented sample plan. The auditor should seek to develop a sampling plan that will provide maximum support for conclusions in return for the time spent in the selection, examination, and evaluation of the sample. Sampling plans must be documented in the audit working papers in sufficient detail to meet the requirements of the GAGAS Attestation Standards.

Detailed elements of a sample plan are:

- Identify audit and sampling objectives;
- Describe the audit universe, sampling universe, and the sampling unit;
- Describe the sampling frame;
- State the sampling technique to be applied;
- For attributes sampling, establish the desired sampling reliability parameters;



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- Determine a sample size consistent with the audit objective and identified audit risk;
- Describe the sample selection method; and
- Describe how sample results will be evaluated.

a. Identify Audit and Sampling Objectives. A prerequisite to the application of any sampling process is the need to identify the specific audit objectives to be attained by examination of the area under evaluation. Prior to initiation of the sampling process, the auditor should definitively set forth in the sampling plan the characteristics and values to be examined during the audit. The auditor's sampling objective should satisfy the audit objectives of the area being audited. The precise type of errors, occurrences, or values being audited must be defined in order to design an economical or efficient sampling plan. The objective should define what specific audit procedures will be applied. To define the objective, the auditor needs to have knowledge or understanding of the audit area to be evaluated. This knowledge can be obtained from prior audit history or other applied analytical procedures, and may require the review of a nonstatistical sample or judgmental selection of items to obtain the necessary knowledge to properly frame an effective audit sample.

b. Describe the Audit Universe, Sampling Universe, and the Sampling Unit. A universe is a group of items or transactions from which information is desired and includes all items which could potentially be examined. The audit universe includes all items selected for 100 percent review and all items with a chance to be examined through random selection. The sampling universe is a subset of the audit universe and consists of items remaining after the large dollar or sensitive transactions have been stratified for complete (100 percent) review or other items where no review will be made based on risk or materiality. The sampling universe is a group of items from which a sample will be selected through random selection. The sampling unit is the basic element that will be examined taking into consideration the use of physical or dollar unit selection. A sampling unit may be a document or record, such as a purchase order or travel voucher, or may be an item reflected on the document or record. The auditor should determine the completeness of the universe before sampling and the working papers should include evidence of reconciliation among the audit universe, sampling universe, and selected items for examination.

c. Describe the Sampling Frame. The sampling frame is the physical (or electronic) representation of the sampling units from which the sample is actually selected. The sampling frame may or may not be synonymous with the sampling universe. For example, the sampling frame may be an electronic file of the contractor's general ledger containing the transactions for all accounts. The auditor should reconcile the universe, the sampling frame, and the sampling universe and document any required adjustments in the audit working papers.

d. State the Sampling Technique to be Applied. Document the type of sampling application to be applied. The auditor must state whether statistical or nonstatistical

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sampling procedures are being applied. For variables sampling, the auditor shall select physical unit or dollar unit. For attributes sampling, the auditor shall identify either acceptance or estimation sampling.

e. For Attributes Sampling, Establish the Desired Sampling Reliability Parameters. As part of the sample plan for attributes sampling, auditors need to establish reliability parameters which provide a minimum acceptable level at which the auditor is willing to express an audit opinion. For variables sampling, the sample plan will not include a goal for sampling accuracy (i.e., precision goal). For attributes estimation sampling, the sampling reliability parameters are the desired precision range and the desired confidence level. For attributes acceptance sampling, the parameters include the critical error rate (CER), government risk (GR), false alarm error rate (FAER), and false alarm risk (FAR). The CER and GR measure government risk or the chance of incorrectly accepting the findings of an attribute. While FAER and FAR measure contractor risk or the chance of incorrectly rejecting the findings of an attribute.

f. Determine a Sample Size Consistent with the Audit Objective and Identified Audit Risk. Sample sizes should be risk based and sufficiently large enough to reasonably provide sample results reflective of the true universe results. The auditor should consider the following in establishing the necessary minimum sample size.

(1) Variables sampling. For universes greater than 250 items, the sample size selected depends on an assessment of two risk related variables:

- tolerable misstatement, and
- expected error rate or estimated variability in questioned ratios.

The table below should be used to determine the appropriate, minimum sample size:

Expected Error Rate or Estimated Variability in Questioned Ratios	Tolerable Misstatement		
	High	Moderate	Low
Low	47	58	77
Moderate	69	86	114
High	87	109	145

The sample sizes in the above table reflect only the minimum number of sample items and cannot be allocated between sample items and high dollar selections. Any high dollar selections would be in addition to the sample sizes shown in the table.

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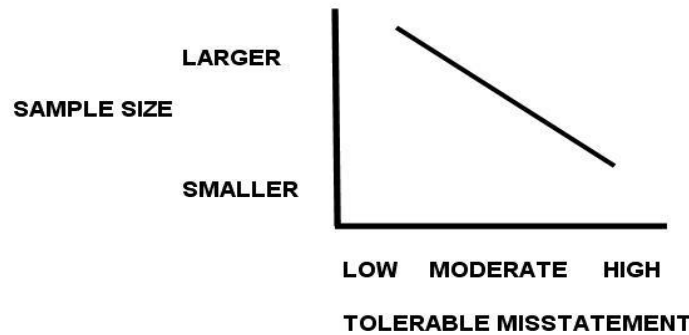
The above table uses a risk of incorrect acceptance of 10 percent or a confidence level of 90 percent. The sampling plan must document the rationale considered to assess the sample size variables and determine the associated minimum sample size. For sampling universes of 50 to 250 items, as a general rule, at least 20 percent of the items, or at least 30 items, whichever is greater, should be selected for examination. The auditor should consider the following in selecting the appropriate risk levels for the two sample size variables.

(a) Tolerable misstatement. Tolerable misstatement is a planning concept and is related to the auditor's determination of materiality. Tolerable misstatement is the maximum error in the population (i.e., the account) the auditor is willing to accept (tolerate). The auditor must select a rating of: low, moderate, or high. When planning a sample for a test of details, the auditor should consider the amount of monetary misstatement in the related account balance that may exist before the account balance is considered materially misstated. The total potential misstatement represents the sum of those misstatements found in the sample, misstatements found through the examination of High\$ items, and misstatements found through other tests outside of the sampling application. This maximum monetary misstatement the auditor is willing to accept for the balance or class of transactions is called the tolerable misstatement.

When an auditor determines very little error or misstatement can exist in the account balance before an adjustment of the account balance would be necessary, the auditor would set the tolerable misstatement as low. As a result, a larger sample size is required in order to ensure misstatements will be identified. For example, if two proposals were of equal value, we would typically have a higher tolerable misstatement for an audit of a cost type proposal versus an audit of a firm fixed price (FFP) proposal. If the cost type proposal had a proposed fee of 10 percent and the auditor found \$100,000 of questioned cost, the impact of the misstatement or questioned cost would be \$10,000. Using the same scenario with a FFP proposal, the impact would be \$100,000 plus applicable profit. As a result, the level of misstatement in the cost type proposal would have to be substantially higher before it approached the same impact to the Government as in the FFP proposal example. Consequently, a higher degree of error is tolerable on a cost type proposal than on a fixed price proposal, and larger sample sizes would be expected for a fixed price proposal. In an incurred cost audit, the level of tolerable misstatement would be higher for a contractor with low Government participation versus a contractor with 100 percent Government participation.

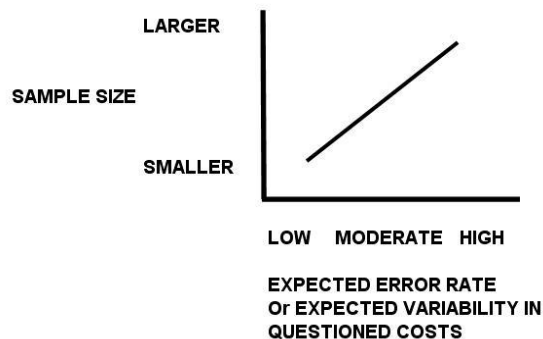
In establishing whether the tolerable misstatement level should be set at high, moderate, or low, the auditor should consider the expected total amount of known and likely misstatements (i.e. questioned costs), and whether separate audit procedures exist which will be used to help formulate an audit conclusion on the account balance or class of transactions. If no or few other audit procedures are performed on this cost element, then the tolerable misstatement should be assessed as low. The greater the number of misstatements or questioned cost that is expected leads to a lower assessment of the tolerable misstatement. A graphical illustration of the relationship between the Tolerable Misstatement and sample size is presented below.

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(b) Expected error rate and expected variability in questioned ratios. In determining a minimum sample size, using the column titled “Expected Error Rate or Expected Variability in Questioned Ratios” the auditor must also select a rating of low, moderate, or high. This column represents the auditor's expectation that audit findings, in terms of costs questioned will represent a low, moderate, or high level. An assessment set at low results in a smaller sample size reflective of the auditor's expectation of few misstatements. An assessment set at high would reflect the auditor's expectations a large number of errors exist in the account. For example, contractor controls to identify unallowable costs are poorly designed or not operational. If it is anticipated that the expected error rate (total cost questioned divided by universe amount) is substantial, then the assessment should move towards “high”.

If significant variability is expected in the individual sampled items' cost questioned ratios (cost questioned/sample item's value), then the assessment should also move towards “high”. For example, if it is anticipated that the cost questioned ratios will vary greatly (i.e., sample item 1 – questioned 20 percent; sample item 11 – questioned 80 percent; sample item 25 – questioned 5 percent, etc.) from sample item to sample item then the assessment should move towards “high”. Larger sample sizes are necessary when the auditor anticipates significant variability in the sample items questioned ratios. A graphical illustration of the relationship between the Expected Error Rate or Expected Variability in Questioned Ratios and sample size is presented below.



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(c) Auditors must consider the Tolerable Misstatement and Expected Error Rate or Expected Variability in Questioned Ratios in determining the sample size. Each sampling application requires its own unique, tailored and documented assessment based on the performing auditor's judgment. Considering both tolerable misstatement and the expected error rate or expected variability in questioned ratios will assist the auditor in selecting a sample size appropriate for the audit; balancing materiality and audit risk. If the auditor has no knowledge regarding the tolerable misstatement, expected error rate, or the expected variability in questioned ratios, the auditor should assess these items using the most conservative assessment possible (i.e., using the largest resulting sample size).

(d) All rationale used in assessing the level of tolerable misstatement and the expected error rate or expected variability in questioned ratios should be adequately documented in the sampling plan. The risk criteria assessment used to determine the sample size must be consistent with conclusions reached in the audit's risk assessment section of the working papers (i.e., working paper section B).

(e) The minimum sample size table is based on sampling theory from monetary unit sampling (i.e., dollar unit sampling), which is the Agency's preferred method of statistical sampling. The table can also be used for physical unit sampling; however, physical unit sampling generally requires the universe be stratified and larger sample sizes (perhaps 10 to 20 percent larger) may be necessary. Should the auditor choose to use the Sample Sizer option in EZ-Quant, a 90 percent confidence level must be used to establish the sample size and it must be no less than the sample size indicated in the table shown in paragraph 4-602.9 f. (1).

(2) Attributes Sampling. Attributes sample size can be determined manually from published sampling tables, or auditors can use the EZ-Quant software (highly recommended) to compute sample sizes for acceptance sampling procedures. The auditor should rank the attributes according to their relative importance. Normally, the most critical attribute will require the largest sample. For each attribute, the required sample size should be determined using the appropriate EZ-Quant acceptance sampling size option. The maximum number of items to be selected will be the largest of all the sample sizes determined for individual attributes.

All attribute(s) sample planning will use a 90 percent confidence level to establish sample sizes and evaluation of sample results. This applies to discovery, acceptance, and estimation sampling. The desired assurance, or confidence level (CL), represents the reliability an auditor wishes to place on the sample results. Since it is often easier to think in terms of risk, the complement of the confidence level (100 - CL) is sometimes used in the EZ-Quant software. This risk term is defined as the "Government's Risk" (GR). The GR shall be set at 10 percent or less when performing an attributes sample, which provides a CL of 90 percent. For Discovery and Acceptance Sampling applications, the auditor must also establish a critical error rate (CER). The CER represents the maximum error rate in the universe considered acceptable by the auditor. For attributes sampling, the CER shall not be set above 10 percent. CERs in excess of 10 percent generate extremely small sample sizes, which

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are too small to draw reliable conclusions about the effectiveness of internal controls. Generally, the CER should be set at 5 percent or less, particularly if no other testing is being performed to formulate a conclusion about the reliability of the internal control being tested. The CER and GR measure risk of incorrect acceptance or the chance of incorrectly accepting the findings of an attribute. In summary, the following parameters should be used when establishing the CER and GR:

Type of Sampling	Risk of Incorrect Acceptance	
	Critical Error Rate	Government Risk
Discovery	≤ 10 %	≤ 10 %
Acceptance: One-Step	≤ 10 %	≤ 10 %
Acceptance: Two-Step	≤ 10 %	≤ 10 %

g. Describe the Sample Selection Method. The sample plan must document how the sample items were selected. A statistical sample requires that sample items be randomly selected and all items must have an equal chance for selection. The auditor may select sample items using a manual process or by utilizing the EZ-Quant sampling software to select sample items. The sample plan must document the process used by the auditor to select sample items. The documentation must be sufficiently detailed to allow for the selection process to be duplicated. This includes documenting the process for stratification, if used. Proper implementation of the auditor's sampling plan requires that:

- (1) the required number of sample items, as established in the sampling plan, be drawn (randomly for statistical sample) from the sample universe,
- (2) each sample item must have an equal chance for selection, and
- (3) each item be evaluated for compliance in the aspects of audit concern (attributes) or that each item be evaluated for acceptability of the recorded cost (variables).

h. Describe How Sample Results will be evaluated. The documented sample plan should identify by name, the specific software application used for sample evaluation or other manual method applied to evaluate the sample results. Use of EZ-Quant software is strongly recommended for all sampling applications. Not only is the software technically sound, but it also assists the auditor in documenting the entire sampling process, from sample planning to sample result evaluation.

### **4-602.10 Sampling Guidelines\*\***

To achieve a desired level of consistency in sampling applications throughout the

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Agency, the following practice statements and guidelines have been established.

a. As part of variables sampling, any items stratified for detailed or more intensive examination will not be considered part of the sample area (sample universe); hence, the results will be appraised separately from the statistical evaluation of the sample result.

This would include high dollar items, other sensitive items removed from the sample universe for separate review, and items that will not be reviewed based on an audit decision of low risk or immateriality.

b. For all statistical sampling applications for variables, initial sample evaluation will be based on a 90 percent confidence level. During sample evaluation, in order to determine if the sample results reflect the true conditions of the universe, the auditor must consider all sources of reliance available and what has been tested in the audit. If no other testing has been performed, the sample results should reflect a greater degree of reliability and accuracy than if other testing has been performed that can corroborate the sample results as being reasonably representative of the true results of the universe. Therefore, the level of acceptable sampling error, measured by precision at a particular confidence level, should be lower if no other testing exists to support the sample results.

c. As part of the sample evaluation, the auditor will determine whether the sample results are representative of the universe and should be projected (i.e., determine if achieved precision at a particular confidence level is sufficiently low enough to conclude the sample results reasonably reflect the true results of the universe). The following factors should be considered during the evaluation process:

- Materiality of the precision amount. In reviewing the achieved precision amount in terms of dollars, the auditor should consider what dollar amount would be considered as tolerable or immaterial. The precision amount can be compared to a materiality threshold because the precision amount is a measure of how much the sample point estimate might understate or overstate the actual universe amount.
- Relationship between precision and point estimate. Auditors should calculate the achieved precision error percentage (Precision Amount/Point Estimate) and compare it to the point estimate. If the achieved precision error percentage is 25 percent or less, the sample is generally considered acceptable for projection purposes and inclusion in the audit recommendation. If the precision percentage is less than 40 percent, the sample results may still be acceptable for projection given other considerations such as the risk associated with the audit, the sampling universe, and other tests performed related to the sampling universe.
- Other tests performed. The auditor should consider what other tests were performed supporting the findings of the sample. If other tests are

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consistent with the sample results, then a larger achieved precision error percentage may be acceptable.

- Risk associated with audit and sampling universe being tested. If more risk is associated with the sample (based on assessments of control risk, inherent risk, overall risk associated with type of audit, etc.), less sampling error, and, therefore, a smaller achieved precision error percentage should be required.
- Qualitative aspects of misstatements or questioned costs. The auditor should carefully consider the qualitative aspects of the misstatements or questioned costs. Exceptions can be due to errors, potential fraud, anomalies, or they may reflect recurring exceptions due to internal control/business system deficiencies. Exceptions related to errors or that are anomalies are of less risk, and the auditor should be able to accept more sampling error or precision. Exceptions due to recurring misstatements, potential fraud, etc. require that the level of acceptable sampling error (precision value) be lower.
- Appropriateness of 90 percent confidence level for evaluating sample results. If the confidence interval is very large (relative to the point estimate), the auditor should consider increasing the sample size or consider acceptance of a reduced confidence level. Using the initial target 90 percent confidence level may have resulted in an excessively wide confidence interval. The auditor could consider evaluating the sample using a lower confidence level such as 80 percent if the level of control risk and/or inherent risk supports this. For example, if control risk was assessed as “Low” or the account under review is not of a sensitive nature, or we have had few findings in the past and/or the audit type is considered to be low risk, a lower confidence level may be acceptable. Furthermore, if a 90 percent confidence level results in a negative lower precision limit, the auditor should consider evaluating the sample with a reduced level of confidence. This does not change the point estimate but does provide a narrower confidence interval associated with the lowered confidence.
- The use of a confidence level below 80 percent is not recommended when the sampling test is the sole basis for supporting an audit position. Sampling applications using less than an 80 percent confidence level should be supplemented with additional audit tests of the same assertion, that when combined provide the auditor with sufficient appropriate audit evidence to afford a reasonable basis for an opinion.

d. All rationale used in determining whether a sample result is acceptable for projection purposes should be thoroughly documented in the audit working papers. If the auditor determines that sample reliability is insufficient to project sample results to the universe (i.e., achieved precision is too high to provide a reasonable level of



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confidence that the sample results reflect the true results of the universe), the auditor must determine what additional steps are required in order to render an opinion regarding the subject costs. The auditor has the option of expanding the sample (increasing the sample size may result in a lower precision amount and precision error percentage), abandon the sample projection and report the results only for the specific items reviewed, or select additional items of interest based on the nature of audit findings and potential for additional questioned cost. The auditor must also consider reporting any other qualitative concerns based on the sample results. For example, if the sample disclosed a CAS non-compliance or system deficiency, the sample results could be used as support for an estimate of the general magnitude of the cost impact in the resulting CAS non-compliance or flash estimating report.

e. To increase the likelihood of achieving acceptable precision results in physical unit sampling, the auditor should stratify the sampling universe. When stratification is used, the minimum number of sample strata will be three and each stratum should have at least 15 sample items. The use of three strata is related to the nature of accounting data, which tends to include a few very large amounts, a number of moderately large amounts and a large number of small amounts. Stratification typically decreases the level of sampling error (reduced precision value) by reducing the range of variability in the sample results in each stratum. Thus, stratification may result in a smaller sample size to meet the audit objective and achieve acceptable precision.

f. In conducting variables sampling – both DUS and PUS, the sampling universe should consist of costs that are essentially alike, or homogeneous. The auditor is more likely to achieve acceptable sampling results that are reliable, accurate, and more easily sustained when the sampling universe contains homogeneous costs. Therefore, during sample planning the auditor should determine if the intended sampling universe consists of transactions that are sufficiently homogeneous to produce acceptable sampling results. The auditor should especially be concerned with the homogeneity of costs if considering combining different indirect cost accounts, costs from one indirect account spread over multiple cost pools, cost centers, or business segments, or direct costs from multiple contracts into one sampling universe. In evaluating the homogeneity of the potential sampling universe of indirect costs, the auditor should consider such items as:

- Are control and inherent risk approximately the same across the sampling universe?
- Are the contractor's policies and procedures governing the costs approximately the same across all pools, accounts, business segments, etc. that might be included in the sampling universe?
- Are the costs in the sampling universe alike enough so that we expect questioned costs across transactions to be for the same general reasons?
- Are the costs in the sampling universe consistent with the intended audit objective?

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- Can we develop an equitable method to allocate projected questioned costs across all pools, accounts, business segments, etc. in the sampling universe?

When determining homogeneity of direct costs, auditors must also consider additional complexities associated with multiple contracts within the sampling universe. Therefore, if the auditor desires to combine direct costs incurred across multiple contracts, the auditor should also consider:

- Are costs homogeneous across all contracts?
- Are the cost questioned percentages expected to be approximately the same across all contracts?
- Are the terms and conditions governing the allowability of costs the same across all contracts?
- Are the policies and procedures affecting the direct costs to be audited the same across all contracts?
- Are the contractor's internal controls the same across all contracts?
- Does it make sense to include different contract types within one sampling universe?
- Can we develop an equitable method to allocate projected questioned costs across all contracts in the sampling universe?

If the auditor concludes the potential sampling universe is not homogeneous, separate sampling applications or stratification of the sampling universe by characteristics other than cost (i.e., by account, pool, business segment, contract, inherent risk, etc.) should be considered.

g. When evaluating the results of a physical unit sample, the auditor must calculate the point estimate and precision using both the "ratio" and the "difference" method. The ratio method computes the ratio of questioned costs in the sample to total costs examined in the sample and applies this ratio to the total costs in the universe. The difference method is also known as the "mean" or "average" method. This method computes the average dollar amount of the questioned costs in the sample (per unit) and multiplies this average by the number of items in the universe. For the audit result, the auditor will use the overall point estimate which has the lowest precision amount and, therefore, produces the smallest confidence interval.

h. Audit Report Narrative. Where sampling methods are used, the resulting audit report must disclose whether the auditor used either a nonstatistical or statistical sample as a basis for the audit conclusions and will include details concerning the sample universe, the sampling method, and sampling unit. The report will state whether the

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statistical sampling results were projected to the sampling universe. Audit reports with projections will also include the confidence level and confidence interval boundary amounts. If the results were not projected, the report should explain the reasons why the results could not be projected.

i. Sampling Indirect Costs in a Multi-Year Incurred Cost Audit. Auditors may use statistical sampling techniques to accomplish audit objectives relevant to multi-year incurred cost audits. In performance of the multi-year incurred cost audit of indirect costs, auditors may select an account in one year for the initial detailed testing and then adjust (increase or decrease) the level of testing required for that account in the remaining years based on the results for the one year of testing. Auditors can use statistical sampling or judgmental selection to accomplish the audit objectives in the initial year as well as the subsequent years subject to examination.

As an alternative approach to selecting one year for testing and using the results to plan the extent and type of testing to perform on subsequent years, auditors may employ statistical sampling techniques across a combination of all years subject to audit. This approach may involve an audit universe consisting of all years combined for a specific account or may require a stratification of the audit universe by incurred cost year. Auditors should base the decision to combine all years into one audit universe or to stratify the audit universe by year on a documented analysis of the homogeneity of the account.

If the auditor considers the costs across all years within the individual account homogeneous, document as such, and then the auditor may combine all years into one audit universe for statistical sampling. Auditors should use the sample size table from 4-602.9f to establish the sample size for the combined sampling universe. Assuming we achieve acceptable precision, we can allocate projected questioned costs among the applicable years by whatever method is deemed appropriate. The allocation method may involve use of the percentage of account value in each year audited, use of the Contributions to Projections screen in EZ-Quant, or some other equitable method. Auditors would then report questioned costs for each audited year along with the confidence interval for the entire sampling universe.

If the auditor desires to perform statistical sampling on all years subject to audit, but the auditor does not consider the costs across all years within the individual account to be homogeneous, auditors either can perform separate and distinct sampling applications of each individual year or can stratify the audit universe by year. If stratification is chosen, the auditor would determine the overall sample size from the sample size table and spread the sample size over the applicable years ensuring that at least 30 items will be sampled from each year. Although we should report questioned costs for each stratum (each year), we should also evaluate the sample results for acceptable precision in total (all years combined). With stratification by year, the audit report should only include the total confidence interval (all years combined) as opposed to confidence intervals for each year.

In determining the homogeneity of costs across years in order to establish the

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most appropriate sampling method, a few items in which auditors should consider are:

- Is the account value and/or transaction volume approximately the same across all years?
- Are control and inherent risk for the selected account approximately the same across all years?
- Have accounting changes occurred within the audited years?
- Has the contractor implemented changes to the accounting system within the audited years?
- Do we expect the percentage of cost questioned to be approximately the same across years?
- Has the contractor changed policies and procedures among audited years?
- Can we appropriately document the homogeneity of costs across years?

j. Sampling Direct Costs in a Multi-Year Incurred Cost Audit. In performance of the multi-year incurred cost audit of direct costs, auditors should review applicable MAARs, other risk assessment procedures, and other related audits to determine what contracts require examination of direct costs within the multi-year incurred cost assignment. Once the auditor selects the contracts and direct cost accounts for examination, they may decide to perform testing in one year initially and then adjust (increase or decrease) the level of testing required for that account in the remaining years based on the results for the one year of testing. Auditors can use statistical sampling or judgmental selection to accomplish the audit objectives in the initial year as well as the subsequent years subject to examination.

Alternatively, auditors may use statistical sampling techniques to accomplish audit objectives through one of, or a combination of, the following sampling approaches:

- Sample in each year individually within each individual contract to be tested.
- Sample all years combined within each individual contract to be tested.
- Sample in each year individually for all contracts combined.
- Sample all years combined for all contracts combined.
- Stratify universe by year for each individual contract to be tested and sample within each contract for each year.
- Stratify universe by year for all contracts combined and sample by year for

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all contracts.

- Stratify sampling universe of contracts by contract and sample all years within each contract.

Before employing statistical sampling techniques across a combination of all years/contracts subject to audit, auditors must determine if direct costs from multiple years can be combined across multiple contracts as explained in 4-602.10f. The auditor should base the decision to combine all years/contracts into one audit universe, or to stratify the audit universe by year/contract, on a documented analysis of the homogeneity of the account.

If the auditor considers the costs across all years/contracts within the individual account homogeneous, document as such, and combine into one audit universe for statistical sampling; either within one contract or multiple contracts combined as explained above. Auditors should use the sample size table from 4-602.9f to establish the sample size for the combined sampling universe. Assuming we achieve acceptable precision, we can allocate projected questioned costs among the applicable years/contracts, and possibly among the applicable contracts, by whatever method deemed appropriate. The allocation method may involve use of the percentage of account value in each year/contract audited, use of the Contributions to Projections screen in EZ-Quant, or some other equitable method. Auditors would then report questioned costs for each audited year/contract along with the confidence interval for the entire sampling universe.

If the costs across all years/contracts within the individual account are not considered homogeneous, auditors can stratify the audit universe by year/contract, determine the overall sample size from the sample size table, and spread the sample size over the applicable years/contracts ensuring that at least 30 items will be sampled from each year. Although auditors should report questioned costs for each stratum (each year) as well as for each applicable contract if multiple contracts are included in the sampling universe, sample results should be evaluated for acceptable precision in total (all years and contracts combined). With stratification, the audit report should only include the total confidence interval (all years and contracts in universe combined).

In determining the homogeneity of costs across years in order to establish the most appropriate sampling method, auditors should consider the information provided in 4-602.10i.

### **4-603 Correlation and Regression Analysis \*\***

This section provides guidance on audit uses for correlation and regression analysis.

a. Correlation and regression analysis are analytical tools. They are simple to use, yet invaluable in audit applications. Correlation analysis is used to analyze the strength of the relationship between variables such as pools and bases. Regression analysis is used to analyze projected overhead or labor rates. Auditors can use analytical

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procedures to assist in evaluating contract costs, but the use of analytical procedures does not eliminate the need for tests of details.

Tests of details must be performed for significant cost elements in all audits. Regression analysis is an analytical tool that can be used in conjunction with, but not a replacement for, tests of details. Certain audit steps must be performed, such as developing an understanding of both the basis of the proposal and the data itself, and ensuring that pooled costs used in the regression are exclusive of nonrecurring costs, fixed costs, or other costs that do not logically correlate with the independent variable. Furthermore, actual cost data should be reconciled to the books and records, and a separate analysis of forecasted values for the independent variable should be performed, among other audit steps. As the audit risk increases (e.g., the examination of rates applied to Fixed Priced and T&M proposals) auditors should perform increased testing of the assertion to provide reasonable assurance that the contractor's proposal is in compliance with FAR Part 31 and CAS, if applicable. This includes procedures related to both the expense pool costs as well as the base costs. The rationale and extent of procedures performed, including the conclusions reached should be appropriately documented in the working paper files.

b. Before using regression analysis, the auditor should first document the expected relationship between the proposed cost variables. Based on contract audit experience, the auditor would expect to see variables with established relationships such as pools and bases, direct labor dollars and overhead dollars, or other industry accepted variables. However, the contractor may have changed the composition of the variables since the last analysis of the proposed rates. For example, cost accounts may have been added or removed from the pool or base, or the contractor may have created new pools or bases. In these cases, the auditor should perform correlation analysis on the new variables.

c. Correlation analysis and scatter diagrams are used in contract auditing to analyze the strength of the relationship between variables such as pools and bases. After first performing a data profile, EZ-Quant is used to perform a computational analysis and graph the direction, form, and degree of the relationship.

(1) Correlation analysis is used to test the relationship between variables. To validate new or changed variables, the auditor should prepare a scatter diagram. Visual inspection of the scatter diagram will show whether the variables have a linear or curvilinear relationship. The diagram will also show the direction of the relationship – positive or negative. Upon evaluation of the new or changed relationship, the auditor can proceed to regression analysis and project pool amounts for different base projections.

(2) Correlation analysis will not result in questioned costs, but may provide a basis to question the contractor's methods for projecting costs. For example, if the contractor is proposing overhead rates based on new pools and/or new bases, the auditor should document the correlation or lack of correlation between the variables proposed by the contractor. Correlation analysis may provide reasonable assurance of

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the causal beneficial relationship between the base and the pool. Conversely, the correlation analysis may show that an inadequate relationship exists between the base and pool. In such instances, the auditor should more closely examine the causal beneficial relationship between the base and pool to determine if another, more representative base may be appropriate.

(3) Correlation analysis may also be used during the risk assessment of incurred cost audits to identify changes in pools or bases from historical data. The analysis may identify changes that need to be reviewed during the audit of the incurred costs.

d. Regression analysis should be used whenever the contractor uses two or more variables to project overhead rates, labor rates or other cost elements. The purpose of regression analysis is to estimate the line that best fits the data points on the XY graph and, provided that correlation is adequate, to predict values of a dependent variable.

(1) The auditor should always request historical data for each cost variable and trace the amount to a verifiable source. When obtaining historical data, keep in mind the larger the number of observations used, the more remote is the possibility of a high  $R^2$  occurring by chance.

(2) If the contractor has projected costs using regression analysis, the auditor will replicate the contractor's results to test the reliability of the contractor's calculations.

(3) In the event the auditor prepares audit-determined rates, the auditor should document the input and results through EZ-Quant.

e. Auditors will use the DCAA approved EZ-Quant software to perform correlation and regression analysis. Use of other commercial software tools is not approved. Audit tools provide valuable assistance, but do not replace the need to use logic and auditor judgment.

f. When the auditor uses regression analysis, the audit report note will disclose the use of analytical tools in the evaluation of contractor's costs or rates. A statement that "regression analysis was used to evaluate the contractor's estimates" will suffice. It is not necessary to report statistics or other descriptive values derived from the analysis unless that detail is relevant to price negotiations and/or if the contractor cited statistics in its proposal. Graphs developed in EZ-Quant or other software should be used to display the regression analysis if the graph will help communicate the audit position.

g. To document the results of regression analysis in electronic working paper files, the auditor should save all tables generated by the EZ-Quant Regression model in one MS Excel workbook. It is recommended that each table be saved as a separate spreadsheet within the single workbook. The input and assessment files should also be saved as electronic working paper files.

h. The Agency does not have a minimal value for the acceptance of an  $R^2$  (coefficient of determination). While it can be any value between 0.0 and 1.0, the higher the better. The  $R^2$  should always be evaluated in view of the F-statistic, comparison

assurance, and Figure 2-1 in the [Graphic & Regression Analysis Guidebook](#).

i. Contractors must indicate how they computed and applied their indirect rates while also showing trends and budgetary data with explanations to support the reasonableness of the rates per the requirements of [FAR Part 15](#). The extent of detail will vary depending on the specific data supporting each fiscal year and based on the size and complexity of the contractor. When auditing proposed indirect rates, auditors should perform substantive procedures to evaluate the reasonableness of the contractor's basis of estimate (e.g., budgetary data and historical costs/trends). When historical contractor data is used to support the basis of estimate, the auditor must document the substantive audit procedures performed (previously or currently) to ensure the historical data is in reasonable compliance with [FAR Part 31](#).

#### **4-604 Improvement Curve Analysis \*\***

This section provides guidance on audit uses for improvement curve analysis.

a. The improvement curve is a concept that, within certain reasonable limits, the knowledge, skills, and techniques employed in the production of a product will improve as production of the product continues without material change and that this improvement will result in corresponding reduction in the time and material required to produce the product (increased efficiency) and, therefore, in the cost of the product. The concept also postulates that the rate of improvement will be relatively regular and constant for any given product; therefore, predictive. By stating these concepts as generalizations, a valuable technique of graphical and computational analysis and a tool for evaluating production requirements and costs has been made available to production planners, analysts, and contract auditors.

b. The improvement curve, like other statistical analysis methods, should not be considered as a complete or absolute procedure; rather, it is an additional analytical tool useful for analyzing and forecasting cost trends when the reasonableness of the historical costs has been established by other means. While historical trends can be determined and measured with fair certainty, no future trend can be predicted with complete certainty. A number of variables including knowledge, skills and techniques, and many others can affect the forecast.

c. The improvement curve theory as presently used by industry and the Government assumes this basic relationship: that there will be a relatively constant percentage reduction in the cost for doubled quantities of production. The improvement curve theory may be applied in the audit evaluation of costs and cost estimates in any industry, provided that the basic assumption of a relatively constant rate of improvement can be shown to be true for the particular cost-quantity relationships being studied. When this relationship is valid for any element of the cost of producing an item, the improvement curve pattern experienced in the production of the item in the past can be extended to obtain predictions of the costs which will be required to produce additional units in the future.



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A further assumption relative to these elements may sometimes be made; namely, that the rate of improvement experienced by a particular contractor on a prior product may be indicative of the rate of improvement which can be expected on a new product of similar size, complexity, and construction. When both of these assumptions are valid, the use of the improvement curve simplifies the problem of evaluating an estimated cost for a new product and permits a more sound evaluation than is possible without the use of the curve. Without the improvement curve technique, the auditor must attempt to evaluate directly either the total cost or the overall average cost for the entire future production. This direct evaluation of an estimate is difficult if the estimate covers an extended period of time even though past cost experience is available. It is more difficult for a new product. Where the improvement curve assumptions are valid, however, the auditor can first evaluate the actual or estimated initial cost of manufacture and from this information the auditor can evaluate both the expected total and the average costs for the production period by using the improvement curve theory.

d. The improvement curve theory is not an expression of an exact or absolute principle. It is a generalization based on observed relationships between production hours and the quantity produced which has been found to be sufficiently true to permit broad usage in the analysis and forecasting of product costs. The concept expresses an approximation, and several variations to the standard methods of application have been developed to address deviations from standard patterns of improvements. These differences represent varying methods of applying the general concept. There are two improvement curve theories: (1) Unit Theory (constant rate of reduction in hours for every doubling of quantities) and (2) Cumulative Average Theory (cumulative average hours reduced by a constant percentage when quantities are doubled).

The auditor must determine the appropriateness of the methods used by the contractor. The auditor should understand the basic principles and the difference between the two slightly different expressions of the basic concept. Although the cumulative average theory was developed first, the unit curve theory is most commonly used. Furthermore, studies of Defense production data have generally provided more support for the unit curve theory. Accordingly, auditors should use the unit curve theory unless there is evidence that the contractor's experience has consistently followed the pattern predicated by the cumulative average curve theory.

e. The improvement curve can be depicted both graphically and mathematically. Hence, projections of anticipated performance can be attained graphically by extending the line of best fit or by computation. While graphics facilitate analysis and presentation in audit reports, and are encouraged for these purposes, the mathematical approach provides more precise estimates and should be used to obtain estimates presented in audit opinions.

f. The auditor should consider the following before applying an improvement curve to data:

(1) Before fitting a line to the data, the auditor must determine whether or not a clear trend exists. This can be determined by plotting the data graphically and

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reviewing the resultant diagrams. If the improvement curve theory is to be applied, the data pattern plotted on a log-log graph (the scales for both the X and Y axes being logarithmic) should show a downward trend as the number of units produced increases and be approximately linear.

(2) The auditor may find that improvement curve assumptions are not valid in particular circumstances. For example the rate of cost reduction may not be constant, or it may be constant only for relatively short periods. In certain operations, unit production costs may reach a plateau where they may remain unchanged for a significant period of time or tend to vary in an erratic manner. Because the basic assumptions of the curve are not always valid, the auditor cannot assume their validity in any particular situation; to do so may lead to invalid conclusions.

(3) When the preliminary study shows that the cost-quantity relationships are sufficiently linear (in log-log form), the auditor should attempt to apply the improvement curve techniques to the forecasting of costs. Data patterns that are otherwise approximately linear may contain variations in the slope of the line or lines of best fit at different stages of production. Most common deviations occur in the early and mature stages of production. There are several improvement curve models (e.g., Stanford B, Leveling, and S-Curve) that address differing rates of improvement during stages of production. In other instances, engineering design changes, production breaks, or retained prior improvement from the manufacture of similar items can cause variations or shifts in improvement curve slopes. The auditor may need to request technical assistance when improvement curves do not fit the typical unit or cumulative average improvement curve theories.

(4) When the cost-quantity relationships are sufficiently linear on a log-log graph to permit the application of the learning curve theory, an improvement curve can be fitted to the plotted data. The preferred and widely accepted method of fitting an improvement curve to data is the least-squares method.

g. The auditor should consider the following when selecting the appropriate improvement curve technique:

(1) *The graphical method* is one in which the forecasted values are derived from a graph upon which historical data have been plotted or one point is plotted and an improvement curve slope is drawn through the plot point. This method is satisfactory for exploratory purposes or where a high degree of accuracy is not required. Although this method is not desirable for expressing an audit opinion, inclusion of a graph in an audit report to depict the visual representation of the audit recommendation is desirable, and graphic analysis should always be utilized in conjunction with mathematical analysis.

(2) *The computational method* is one in which the forecasted values are computed directly from the curve derived from the data. To eliminate the cumbersome procedure of manually computing projected costs, two methods of streamlined calculation are available: (1) tables of improvement curve factors and (2) the DCAA's

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EZ-Quant computer software. The second option is the best method for both improvement curve estimation and cost projection. In addition to the significant savings in time and the superior accuracy of computer-based analysis, the computerized approach permits more complete and in-depth analysis than is possible by any other means.

h. Auditors should use DCAA's EZ-Quant software to perform improvement curve analysis. Use of other commercial software tools is not approved. EZ-Quant includes the following improvement curve models:

(1) Estimated least squares curve fits to data using the unit curve theory and the cumulative average theory models.

(2) Models to project values on an improvement curve defined by a percentage slope and the cost of any unit or lot.

(3) Special application improvement curve models which account for engineering design changes, production breaks, retained prior improvement, or variations in production rates.

i. The best possible source of improvement curve data is the historical records of the contractor who is producing an item. If the contractor has produced the same item in the past, its records can usually be used to estimate both the percentage slope and the theoretical first unit. Even if the contractor has not produced the item before, its experience in producing other items at the facilities planned for the new item will generally provide a more reliable percentage than the experience from another contractor. It should also be noted that while improvement curves can best be fitted to direct labor hours or costs which have been segregated by unit or lot, it is often possible to develop satisfactory improvement curves from monthly or weekly costs and equivalent units of production, or even from cost recorded against successive contracts.

j. When the auditor uses improvement curve analysis, the audit report note will disclose the use of analytical tools in the evaluation of contractor's costs. A statement that "improvement curve was used to evaluate the contractor's estimates" will suffice. It is not necessary to report statistics or other descriptive values derived from the analysis unless the data will be of value during negotiations. Graphs should be used to display the improvement curve analysis whenever costs are questioned using the technique.

k. To document the results of improvement curve analysis in electronic working paper files, the auditor should save all tables generated by the EZ-Quant Improvement Curve model in one MS Excel workbook. It is recommended that each table be saved as a separate spreadsheet within the single workbook. The input and the assessment files should also be saved as electronic working paper files.

### **4-700 Section 7 - Responsibilities for Detection and Reporting of Suspected Irregularities \*\***

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### **4-701 Introduction \*\***

This section covers procedures, audit guidance, and responsibilities relating to fraud, other unlawful activity, and anticompetitive practices. For unsatisfactory conditions not covered by this section see 4-800.

### **4-702 Suspected Fraud and Unlawful Activity - General \*\***

#### **4-702.1 General \*\***

a. When auditing a contractor's records in accordance with government auditing standards, auditors may encounter, or receive from other sources, information constituting evidence or causing suspicion of fraud or other unlawful activity. (Examples of other unlawful activity include violations of the [Anti-Kickback Act](#), anticompetitive (antitrust) practices, and illegal political contributions.) Sources for such information may include company employees, disgruntled participants, or others making allegations by letter, telephone, personal visit, or through a third party. Such information may pertain to acts of:

(1) military personnel or civilian employees of the Government in their relations with the Government.

(2) military personnel or civilian employees of the Government in their relations with individuals or firms.

(3) individuals or firms in their business relations with the Government.

(4) individuals or firms in their business relations with other individuals or firms doing business with the Government.

b. Definition. For purposes of this chapter, the term "fraud" or "other unlawful activity" means any willful or conscious wrongdoing, including, but not limited to, acts of cheating or dishonesty which contribute to a loss or injury to the Government. Some examples are:

(1) falsification of documents such as time cards or purchase orders

(2) charging personal expenses to Government contracts

(3) submitting false claims such as invoices for services not performed or materials not delivered

(4) intentional mischarging or misallocation of costs

(5) deceit by suppression of the truth

(6) bribery

(7) corrupt payments which violate the Foreign Corrupt Practices Act

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(8) theft

(9) a Government employee acquiring a financial interest in or seeking employment with a contractor over whom the employee exercises oversight

(10) kickbacks

(11) any unlawful or fraudulent acts resulting from accounting classification practices designed to conceal the true nature of expenses, e.g., classifying unallowable advertising or entertainment costs as office supplies

(12) product substitution or false certification that tests were performed

(13) when the contractor is invoicing costs but is delinquent in paying accrued costs in the ordinary course of business

(14) any attempt or conspiracy to engage in, or use, the above devices

### **4-702.2 Auditor Responsibilities for Detecting and Reporting Fraud \*\***

a. The audit team should design examination engagements to detect instances of fraud and noncompliances with provisions of laws, regulations, contracts, and grant agreements that may have a material effect on the subject matter. Refer to 4-702.3 for guidance on audit procedures to detect and respond to the presence of fraud risk indicators/factors.

b. The assessment of the risk of material noncompliance due to fraud is a cumulative process that:

(1) includes a consideration of risk factors individually and in combination,  
and

(2) should be ongoing throughout the audit.

c. The audit team should also exercise:

(1) due care in planning, performing, and evaluating the results of audit procedures, and

(2) a proper degree of professional skepticism to achieve reasonable assurance that the subject matter of the audit is free of material noncompliance due to error or fraud.

d. Auditors are not trained to conduct investigations of illegal acts. This is the responsibility of investigators or law enforcement authorities. When an auditor obtains information that raises a reasonable suspicion of fraud or other unlawful activity that has not been previously disclosed to the Government, the auditor should issue an investigative referral (see 4-702.4).

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e. The auditor should not defer issuing an investigative referral until completion of the audit. Neither should the referral necessarily take place as soon as the auditor is confronted with a fraud indicator. The auditor should follow up on fraud indicators until he or she is satisfied that an adequate explanation of the irregularity is not likely or no further relevant information will be generated through audit techniques. The auditor must avoid the appearance of conducting an investigation. If the auditor is in doubt about the propriety of a proposed audit step, the auditor should request guidance from their supervisor or FAO manager. Audit support of investigations is covered in 4-702.6 and 4-702.7.

f. Auditors should document in the working papers and promptly report to FAO management suspected irregularities disclosed through audit steps and procedures, or discovered by an auditor inadvertently (e.g., conversation overheard, information disclosed to an auditor, either in person or through an anonymous tip).

g. Treat as a possible audit lead any allegation received from outside sources, such as telephone calls, anonymous letters, and contractor employees. If there is further evidence available at the FAO to support the allegation and a reasonable basis to suspect fraud or other unlawful conduct, report the suspicions in accordance with 4-702.4. If the allegation provides a reasonable basis to suspect fraud or other unlawful conduct, but there is no further corroborating evidence, relay the allegation using the [DCAA OIG Hotline](#) or the [DoD OIG Hotline](#) (4-702.4a(1)).

### **4-702.3 Audit Procedures for Detecting and Responding to Fraud Indicators/Factors \*\***

a. When planning the audit, the audit team should perform information-gathering procedures (IGPs) to gain an understanding about the contractor and its environment. These procedures include management inquiries (4-702.3b-c), analytical procedures (4-702.3d), audit team discussion(s) (4-702.3e-g), and understanding the relevant internal controls that address the identified fraud risk factors (4-702.3i). The understanding gained from these procedures assist auditors in identifying relevant fraud risk factors (4-702.3h, j-k) and designing audit procedures to detect material noncompliances due to error or fraud (4-702.3l-o).

#### **b. Management Inquiries**

Management inquiries are very important for effective audit planning because fraud is often uncovered through information received in response to inquiries. The audit team should make the following inquiries of contractor management responsible for the subject matter under audit:

- Whether management has knowledge of any fraud or suspected fraud affecting the subject matter under audit;
- Whether management is aware of allegations of fraud or suspected fraud affecting the subject matter under audit, for example, received in communications from employees, former employees, regulators, or others;

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- Management's understanding about the risks of fraud relevant to the subject matter under audit, including any specific fraud risks the contractor has identified or account balances or classes of transactions for which a risk of fraud may be likely to exist.

The audit team should make these inquiries in every audit. The audit team should use information obtained at annual planning meetings about the contractor's programs and controls that mitigate fraud risk in order to facilitate additional inquiries related to the subject matter under audit. When possible, the audit team should conduct inquiries as part of face-to-face discussions. This provides auditors with an opportunity to measure responses and ask follow-up questions. If there are instances of inconsistent information, the audit team should obtain additional audit evidence to resolve the inconsistencies.

c. Analytical procedures, combined with the audit team's understanding of the contractor and its environment, serve as a basis for additional inquiries and effective audit planning. When the results of analytical procedures differ from expectations, auditors should resolve the differences through further inquiries. While the differences in expectations may not necessarily indicate the existence of fraud, the audit team should be aware that some differences could represent a fraud risk factor and they should respond accordingly.

### d. Audit Team Discussion

Prior to, or in conjunction with the information gathering procedures, members of the audit team (at a minimum the auditor and the supervisor) should discuss the potential for material noncompliances due to error or fraud. The discussion should include an exchange of ideas or "brainstorming" among the audit team members about how and where they believe the subject matter under audit might be susceptible to material noncompliances due to error or fraud and how management could perpetrate and conceal fraud.

e. The audit team discussions should include consideration of relevant prior audit experience (e.g., questioned costs, relevant reported estimating or accounting system deficiencies, audit leads) and relevant aspects of the contractor's environment. This includes discussion of the relevant fraud risk factors, other known risk factors, and the audit team's understanding of relevant internal controls. The audit team should document how and when the discussion(s) occurred, the team members who participated, the subject matter discussed, and the outcome.

f. A number of factors will influence the extent of the audit team discussion. For example, if the audit involves more than one location, there could be multiple discussions with team members in differing locations. Another factor to consider in planning the discussions is whether to include specialists assigned to the audit team. For example, if the auditor determines that the team needs a professional, possessing information technology skills, he or she may want to include that individual in the discussion.

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### g. Fraud Risk Factors

The audit team should be familiar with the [DoDIG Contract Audit Fraud Scenarios](#) and the examples of Indicators of Fraud Risk in the [GAGAS Appendix 1, Section A.10](#). In addition, [AT 601.33](#) requires auditors to consider the risk factors identified in [AU-C 240.A75 \(Appendix A\)](#). The risk factors cover a broad range of situations, therefore, not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different sizes or with different ownership characteristics or circumstances. Refer to the standard audit programs and the listed CAM sections in the table below for additional risk factors in the following audit areas:

Audit Area	CAM/Guidebook Reference
General	Figure 4-7-3
Internal Control Audits	5-100
Accounting for Material Cost	6-305
Storing and Issuing Materials	6-312
Labor Cost Charging and Allocation	6-404.6
Floor Checks	6-405.2/.3
Overtime	6-409.2
Consultant Costs	Selected Areas of Cost guidebook, Chapter 58
Defective Pricing Audits	14-121
IT System Audits	5-400

h. Certain characteristics or circumstances provide opportunities to carry out fraud. The auditing standards and the DoDIG's Contract Audit Fraud Scenarios identify weaknesses in internal controls as fraud risk factors and in some cases uses weak internal controls as examples in the fraud risk scenarios. Some of these examples are the lack of segregation of duties, inadequate monitoring by management for compliance with policies, laws and regulations, and lack of asset accountability or safeguarding procedures. The audit team should be aware of these fraud risk factors when obtaining their understanding of relevant internal controls and respond accordingly. However, while these factors may be present in many small contractors, an opportunity to carry



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out fraud does not necessarily indicate the existence of fraud. The audit team also should keep in mind that the levels of internal controls for smaller contractors are likely to be less formal and less structured.

i. It is important to note that the audit team is not auditing to the fraud risk factors. They are not the objectives of the audit. The audit team gains an understanding of the contractor and its environment through the information gathering procedures. From this understanding, and awareness of what the risk factors are, auditors should be reasonably sure they would detect materially relevant fraud risk factors.

j. The audit team should document on Working Paper B, all fraud risk factors identified during the performance of the audit. For each identified factor, the audit team should reference the working paper that specifically addresses their response and the result of that response. If the team identifies no risk factors, they also should document this on Working Paper B.

### k. Responding to the Presence of Fraud Risk Factors

The audit team should respond to the presence of fraud risk factors by designing audit procedures that (i) impact the overall conduct of the audit (4-702.3m); (ii) modify the nature, timing and extent of the audit procedures (4-702.3n); and/or (iii) address the risk of management override of controls (4-702.3o).

l. Responses that affect or influence the overall conduct of the audit generally relate to the assignment of personnel and supervision, predictability of auditing procedures, etc. For example, a supervisor generally should not assign a trainee to an audit when there were suspicions of fraud without the support of a more experienced audit team member or technical specialist.

m. Responses that modify the nature, timing or extent of the audit procedures describe how the “normal” audit procedures changed in some way to address the risk of fraud. The audit team should use professional judgment to determine which modifications are necessary to address the risk of fraud by designing additional or different auditing procedures to obtain more reliable evidence or additional corroboration of management’s explanations or representations (e.g., third-party confirmation, analytical procedures, examination of documentation from independent sources, or inquiries of others within or outside the entity).

n. Management has the unique ability to perpetrate fraud by overriding controls that otherwise may appear to be operating effectively. Responses that address the risk of management override of controls generally relate to examining journal entries and other adjustments for evidence of possible material misstatement due to fraud, reviewing evidence of arbitrarily managing contracts to budgets, and evaluating the rationale for significant accounting and organizational changes.

### **4-702.4 Procedures for Referring Suspicions \*\***

a. There is no requirement for the auditor to prove the existence of fraud or other

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contractor irregularities in order to submit a referral. Upon encountering or receiving information which raises a reasonable suspicion of fraud, corruption, or unlawful activity (see 4-702.3) relating to a Government contract:

(1) Promptly prepare a DCAA Suspected Irregularity Referral Form ([DCAAF 2000](#)). A copy of the DCAAF 2000 is included as Figure 4-7-2 and the latest version can be found on the DCAA Intranet and APPS. The auditor may also use the DCAA Hotline or DoD Hotline to report suspected irregular activities. However, the use of the DCAAF 2000 is the preferred method for forwarding this information. It specifies the information needed by investigators and provides for appropriate consideration of audit impact. When issuing a referral to the DCAA-Hotline or DoD Hotline a DCAAF 2000 should not be used, instead follow the most current guidance issued by the [DCAA Hotline](#) or [DoD Hotline](#). Similarly, for non-DoD programs follow procedures provided by the OIG of the agency responsible for the basic contract. Also, DCAAF 2000 can be used to report irregularities affecting non-DoD contracts, follow the same procedures for DoD referrals below. If the irregularity does not affect DoD contracts, the matter would be reported to the inspector general of the agency most at risk.

(2) When a [DCAAF 2000](#) is used, fully describe the potential fraudulent condition, keeping in mind the need for conciseness, including appropriate reference to the procurement regulations or statutes, which the auditor believes may have been violated. General reference is sufficient, i.e., the auditor is not expected to conduct legal research to identify citations. Include information on contractor efforts to hinder or obstruct audit work which uncovered the suspected fraud (see 4-708). Forward the referral to Headquarters (see 4-702.4(b)) through the FAO's management. Management reviews of the DCAAF 2000 prior to formal submission to Headquarters should be limited to that necessary to ensure clarity and completeness. No attempt should be made to dissuade an auditor from completing and submitting a DCAAF 2000.

(3) Care should be taken to avoid unnecessary use of legal terminology or proliferation of enclosures beyond those necessary to explain the problem. The purpose of the [DCAAF 2000](#) is to alert an investigator to a possible irregularity, not to establish that the reported irregularity is a violation of the law.

(4) The auditor's obligation to protect contractor's records from unauthorized access requires that the distribution of documents which appear to provide evidence of impropriety be restricted. Protection and strict control of all information related to the suspicion of fraud and other contractor irregularities is critical. Premature or inadvertent disclosure could compromise the Government's efforts to gather needed evidence. Place a reference to the draft [DCAAF 2000](#) in the audit working papers to establish a record of events leading up to the decision to make a referral. In addition, annotate a summary of the events and any other relevant information that would likely be useful in the performance of future audits in the Electronic Contractor Permanent File ([ECPF](#)) system, folder B-07 Fraud Risk Indicators using the standard audit lead sheet, (see 4-403e(4)). To prevent inadvertent disclosure of sensitive information, the actual DCAAF 2000 should not be stored in the ECPF system. Headquarters will maintain an official DCAAF 2000 in accordance with the specified records retention requirements.

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(5) Continue with assigned duties and pursue development of factual information as appropriate or indicated by 4-702.5. Coordinate any continuing evaluation with your supervisor or FAO manager.

b. Submit DCAA Form 2000 ([DCAAF 2000](#)) referrals as follows:

(1) For referrals containing unclassified information, the FAO Manager will send an encrypted e-mail, attaching the dated and signed DCAAF 2000 in a Portable Document Format (PDF) file (see also 4-702.4(c) below) and send to Headquarters, Justice Liaison Auditor, at the following e-mail address: DCAA-JLA@dcaa.mil or mail to Headquarters, Attention: Justice Liaison Auditor, using regular first-class mail.

(2) For referrals containing unclassified information but originating from Field Detachment activities, the FAO Manager will send an encrypted e-mail, attaching the dated and signed DCAAF 2000 in a PDF file (see also 4-702.4(c) below) and send to Operations Investigative Support (OIS) Special Programs supervisor at the following e-mail address: DCAA-OIS-SPForm2000@dcaa.mil. Do not send any classified information to this email address. Coordinate with OIS Special Programs supervisor for referrals on classified programs/contracts.

c. Other electronic files such as MS Word, MS Excel, or PDF may be included or attached to the [DCAAF 2000](#). However, because DCAAF 2000s are usually transmitted through email, it is recommended that files not exceed 5MB in order to maximize the effectiveness of its delivery. Ensure attached files are cross-referenced to information on the DCAAF 2000 or any detailed narrative of events. Large data files may be referenced on the DCAAF 2000 and made available to investigative agencies upon request.

d. Information and documents, including any internal pages, generated as a result of the activities prescribed above will be marked "FOR OFFICIAL USE ONLY" at the bottom of the page unless the information warrants a security classification, in which case the appropriate security markings will be affixed to the documents.

### **4-702.5 Audit Activities Subsequent to Referral - Continuing Audits \*\***

a. Following a referral, or after notification of the initiation of an investigation, take no actions that would compromise an investigation. For example, do not attempt to establish wrongdoing (an investigative responsibility) nor inform the contractor that a fraud referral has been made. Continue to follow up on fraud indicators through the normal course of the audit. This is similar to the manner in which a tentative decision to question costs would be followed. Do not expand the audit scope for the sole purpose of gathering additional information to support an investigation. The auditor must avoid the appearance of conducting an investigation. If audit activities relate to an area under investigation or litigation, coordinate with the cognizant investigative or prosecuting organization before taking any final administrative action. An example of such an audit activity is the issuance of final audit-determined indirect cost rates. Audit activities outside the area of investigative interest will continue unless the investigative organization requests in writing (e.g., letter or email) that they be deferred or suspended

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(see also 4-702.5(e) below). If it is believed the requested deferral will cause financial harm to the Government or unnecessarily impede the audit mission, elevate the matter for management resolution between the respective organizations. Before any decision is made to defer or suspend an audit, coordinate the matter with Headquarters (OIS).

b. Upon request, furnish a draft copy of any audit report issued in connection to a submission of a [DCAAF 2000](#) to the appropriate investigative organization. Also, coordinate with the DCAA Justice Liaison Auditor (JLA) for any information developed later, relating to the suspected wrongdoing or similar misconduct, without filing a separate DCAAF 2000. Reference all future correspondence and/or updates with the DCAA case number assigned by OIS.

c. Suspicions of fraud or other unlawful activity may be so serious as to prevent the issuance of an unqualified audit report or lead to a recommendation that contract payments be halted pending resolution. If additional time is required to develop factual information for an audit impact determination, the final audit report can usually be delayed for DCAA-initiated assignments. See 4-702.5(a) and (e) before issuing a report. Examples of such assignments are operations audits, estimating system surveys, or postaward audits. However, when an audit report is scheduled for issuance within a specified time frame (e.g., a report on a price proposal audit) the suspected condition may have a serious impact on the auditor's ability to meet the due date. When this occurs:

- (1) Consult the regional office and Headquarters (OIS).

- (2) Contact the Plant Representative/ACO or the representative of a non-DoD agency, as appropriate, to explain the condition and arrange for an extended report due date. Do not do this, however, if the contracting representative may be involved in the suspected unlawful activity.

- (3) Qualify the report if a due date cannot be extended, and inform the requestor by separate letter of the circumstances affecting the situation (see 4-702.5 (a) and (e)).

- (4) Question any costs improperly claimed as a result of the suspected wrongdoing (see 4-702.5 (a) and (e)).

d. Protect and strictly control all information related to the suspicion of fraud or other unlawful activity. This is to protect the reputations of innocent persons and ensure that information is not prematurely or inadvertently disclosed to persons suspected of wrongdoing. Premature or inadvertent disclosure could compromise the Government's efforts to gather needed evidence. Control and protect all such information as follows:

- (1) During normal duty hours, keep the documents in an out-of-sight location if the work area is accessible to nongovernment personnel (e.g., contractor personnel).

- (2) After duty hours, place hard copy documents in locked receptacles such as file cabinets, desks, or bookcases. If necessary, relevant information may be stored

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in the Electronic Contractor Permanent File ([ECPF](#)) system, follow procedures in 4-702.4(a)(4).

(3) When such information is being disseminated outside DCAA transmit them in a manner which will prevent inadvertent release to unauthorized persons.

e. Do not issue an audit report on any part of a representation containing a fraudulent claim without first coordinating with the JLA (see CAM 2-404(c)). Normally there is no need to withhold an audit report unless it can be demonstrated that its issuance would hinder an investigation or prosecution. Before a decision is made to withhold an audit report, the FAO or region should coordinate the matter with the JLA. Unless otherwise instructed, the FAO will send the original audit report to the responsible contracting officer/ACO along with a separate cautionary transmittal memorandum regarding the suspected unlawful activity. See Figure 4-7-1 for an example. However, a separate transmittal memorandum may not be necessary when a copy of the DCAA Form 2000 ([DCAAF 2000](#)) was furnished to the responsible contracting officer, see 4-702.5(f) below for restrictions and other considerations. Do not make reference in the audit report to suspected irregular conduct or a referral for investigation, and do not send copies of the transmittal memorandum or DCAAF 2000 to other parties. In circumstances where Government contracting representatives may be involved in the suspected unlawful activity, do not furnish a copy of the DCAAF 2000 or use the transmittal memorandum if, per discussion with the cognizant investigative agency, the information contained therein would interfere with a pending investigation.

f. Effective communications throughout the audit is an important aspect of the audit function. Continuous communication keeps the requestor/contracting officer informed of major preliminary audit issues and problems (see 4-100). This includes the suspicion of fraud, illegal acts, or violations of provisions of contracts. However, it is DCAA policy to promote and maintain strong controls in order to protect the integrity of a potential investigation. When communicating information relating to a matter referred for investigation, the JLA will coordinate with investigative agencies an assessment period of 30 days. The FAO should coordinate with the JLA when situations require communicating these matters with the contracting officer during the investigative agencies assessment period. An example of activities that may require immediate communicating may include final administrative action such as issuance of final audit-determined indirect cost rates or issuance of suspension or disapproval of costs or payments ([DCAA Form 1](#)). Do not communicate the existence of a DCAAF 2000 with the contracting officer when it is obviously inappropriate (e.g., ACO or PCO is involved). Information relating to a matter referred for investigation will be protected and not released or disclosed to a contractor, or a contractor's employee, representative, or attorney. This policy is based on the need to avoid the disclosure of information which might impede or compromise an investigation. A regional director or head of a principal staff element may make a case-by-case exception to this policy after consultation with the cognizant investigator and OIS.

g. Representatives of a contractor seeking protected information might take unusual measures to contact the auditor away from the workplace. If an attempt to

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contact the auditor outside normal working hours or workplace occurs, notify the region and Headquarters OIS.

h. Since the information on the [DCAAF 2000](#) is obtained from the performance of our normal audit activities, it is documented in existing working papers for those assignments and when necessary, using the standard audit lead sheet. Therefore, it is the information from those working papers and any audit lead sheet that should be used when planning the scope of future audits, see also 4-702.4(a)(4).

### **4-702.6 Investigative Support Responsibilities \*\***

a. The auditor's responsibility for detecting fraud on any given audit ends with the submission of a DCAA Form 2000 ([DCAAF 2000](#)) or Hotline referral. The cognizant investigative agency is responsible for directing, monitoring, and reporting on the status of fraud investigations. Investigative support to DoD investigative organizations is authorized by [DoD Instruction 7600.02](#), "Audit Policies," dated October 16, 2014. The Operations Investigative Support (OIS) Division typically performs this function.

b. FAO auditors should not support formally constituted investigations, instead furnish any request for assistance to OIS. The FAO may provide audit records at the request of the investigative agency; however, the FAO should coordinate these matters with OIS to ensure only information readily available from the audit files are provided (see 1-405). Under no circumstances is the FAO to contact the contractor or access contractor information by any other means to obtain data or other information in support of an investigation. A formally constituted investigation is one which:

- (1) has progressed beyond the preliminary inquiry stage,
- (2) has been assigned an investigative case number, and

(3) has resolved all issues regarding notification of the contractor under investigation. It is the investigator's responsibility to notify the contractor that it is under investigation and that OIS auditors are supporting the investigation. No DCAA employee should inform a contractor that it is under investigation. Contractor documents or information that DCAA has collected in the course of its normal audit activities may be provided to an investigator through the OIS auditor supporting the investigation. However, the OIS auditor will NOT permit investigators to use DCAA's authority to obtain information or documents directly from the contractor related to the investigation. Investigative organizations must use their own authority to obtain documents or information from the contractor.

It is the investigator's responsibility to notify the contractor that it is under investigation and that DCAA auditors are assisting. This should be done before DCAA provides support to an investigation requiring access to contractor personnel or records located at the contractor's facility.

c. Investigators have the authority (through inspector general or grand jury subpoenas and search warrants) to obtain documents normally not available to DCAA

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in performing its mission. When assigned to support an investigation, auditors will not have investigators use their authority to obtain, for DCAA's use, information or documents not related to the investigation. Conversely, auditors will not use DCAA's authority to obtain for investigators information or documents not related to the investigation.

d. Auditors will:

(1) provide Government investigators and prosecutors ready access to applicable DCAA working paper files, including contractor-generated material contained therein,

(2) list in the working papers or [DCAAF 2000](#) file copies of working papers and other data provided to investigators, and

(3) document in the working papers or the Electronic Contractor Permanent File ([ECPF](#)) system, folder B-07 Fraud Risk Indicators any meetings with members of governmental investigative agencies (see CAM 1-405).

### **4-702.7 Control of Documents Obtained Under Inspector General or Grand Jury Subpoenas and Civil Investigative Demands \*\***

For criminal investigative purposes, documents may be obtained under either an Inspector General (IG) or a grand jury subpoena. The civil investigative equivalent of a grand jury subpoena is referred to as a civil investigative demand (CID). DCAA subpoenas will not be used in connection with investigations. When an investigative office obtains documents under an IG subpoena, it is the custodian of the documents. When the documents are obtained under a grand jury subpoena, the grand jury is the custodian and the Government prosecutor or the investigator acts as the grand jury's agent or representative. Similar custodial requirements exist for CIDs. Requirements for safeguarding grand jury materials or CIDs are more stringent than for IG subpoenas.

a. Auditor responsibility for safeguarding contractor records is discussed in 1-507. The auditor is not relieved of responsibility simply because the records in question have been obtained under subpoena or because the contractor itself should be excluded from access to the subpoenaed records. When auditors are assigned to assist an investigation, they should be aware of their responsibility to exercise due care and be mindful that removal of original documents from the designated workplace could result in both significant embarrassment to the Agency and penalties to the auditor.

b. If an auditor is to work directly with an investigator or trial attorney, the acknowledgment of the request for audit services should state that, while the auditor will exercise due professional care, neither the auditor nor the Agency can assume responsibility for the completeness of subpoenaed documents that are not inventoried upon receipt and maintained under appropriate security thereafter.

c. If unsatisfactory conditions are encountered, the cognizant manager or supervisor should advise the head of the investigative agency of the situation in writing. The matter should then be left to the discretion of the investigative office. It is highly

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unlikely that security problems will arise under a grand jury subpoena; however, in that case, notice of unsatisfactory conditions should be furnished to the trial attorney with a copy to the investigator.

### **4-702.8 Audit Reports Involving Alleged Subcontractor Fraud \*\***

a. Most fraud statutes provide for measurement of total cost impact to the Government for damages resulting from subcontractor fraud or false statements. For example, a second-tier subcontractor may make a false statement to a first-tier subcontractor resulting in a \$1 million defective pricing. If the first-tier subcontractor and the prime contractor rely on the defective data, the impact to the Government would exceed \$1 million after adding the two additional levels of overhead, G&A, and profit. In this example, the second-tier subcontractor would be liable for the entire cost impact to the Government (plus penalties) even though its gain was only \$1 million. This situation differs significantly from a non-fraudulent defective pricing case where the Government would seek recovery of the entire cost impact from the prime contractor. In non-fraudulent subcontractor defective pricing cases, the audit report procedures described in 10-602b. apply (i.e., subcontract audit reports are provided to the prime contract auditor who issues a consolidated report to the procurement authority).

b. In subcontract fraud matters, auditors at subcontractor locations are usually requested by investigators or attorneys to determine the total cost impact to the Government. In such cases, the auditor supporting the investigation of the subcontractor should assume full responsibility for coordinating all audit activity necessary to respond to the request. Accordingly, the subcontractor investigative support auditor should request audit assistance from FAOs with audit cognizance over any higher-tier contractors and incorporate the results into a single consolidated report or memorandum to the requestor. Use this procedure regardless of the number of higher-tier contractors. As part of this process, the subcontractor investigative support auditor should identify information needed from the higher-tier locations and supply the higher-tier auditors with any data necessary to assist them in their work. In acknowledging the request from the investigators or attorneys, the cognizant investigative support auditor should inform the requestor of arrangements being made for the submission of reports on any:

(1) technical analysis or

(2) evaluations of intracompany or higher-tier contractor additive factors.

c. Resolve any disputes between regions on administrative procedures or technical accounting matters that arise during assist audits in accordance with 6-807.

### **4-703 Suspected Contractor Provision of Improper Gifts/Gratuities to Government Personnel \*\***

a. The Standards of Ethical Conduct for the Executive branch ([5 C.F.R. Part 2635](#), Subpart B) state that federal employees shall not accept gifts/gratuities directly or indirectly which are given because of the employee's official position or which are given to the employee by a prohibited source. "Direct or indirect acceptance" includes gifts to



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an employee's parent, sibling, spouse, child or dependent relative given because of the employee's relationship to that other person. "Prohibited sources" are any person or legal entity that:

- (1) seeks official action from the employee's agency;
- (2) does business or seeks to do business with the employee's agency;
- (3) conducts activities regulated by the employee's agency;
- (4) has interests that may be affected by the performance or nonperformance of the employee's duties; or
- (5) is an organization, a majority of whose members fall within any one or more of the prior four categories.

b. The Standards of Ethical Conduct for the Executive branch are found at Chapter 2 of [DoD's Joint Ethics Regulation \(JER\), DoD 5500.7R](#). Additionally, [18 U.S.C. 203](#) makes it a crime for a Government employee to receive compensation for his or her duties as a Government employee from anyone other than the Government. It also makes it a crime for someone to pay such compensation to a Government employee.

c. A violation of 18 U.S.C. 203 or [DoDD 5500.7](#) may become the subject of an investigation and can result in disciplinary action. DCAA auditors do not have a designated mission to monitor compliance with either the Standards of Ethical Conduct or the statute; consequently, audit programs do not contain specific steps to detect noncompliance. However, any apparent noncompliance coming to your attention, regardless of the length of time since the suspected event occurred, is referable. Be aware, however, that there are exclusions from the definition of a gift and a number of listed exceptions to the gift prohibition including a blanket exception for gifts valued at less than \$20 per occasion and \$50 per calendar year. The exclusions and exceptions are found in Section 204 of 5 C.F.R. Part 2635, Subpart B. Additional exceptions are found in Chapter 2 of the JER. Section 204 of 5 C.F.R. Part 2635, Subpart B also provides exceptions for Federal agency ethics officials to permit the gift of free attendance to a "widely attended gathering" to be accepted by a Federal official when there is agency interest in that employee's participation in the event [e.g. a conference, dinner, reception, etc.] Therefore, be sure to evaluate these exceptions before making a referral. Forward suspected offers or acceptances of gratuities even though no recipient can be identified or no investigative lead is apparent. The requirements for referral of personnel from other Federal agencies who have accepted gifts, gratuities, loans, favors, or entertainment are the same as those for DoD employees (see 4-704).

(1) The referral ([DCAAF 2000](#) may be used) must contain as much information as is available. Such information includes the identity of the offeror and recipient (names, position titles, and agency/department or contractor), type of gratuity, range in dollar value of the gratuity or benefit detected, estimated total dollar value, the records reviewed, whether access to any records was denied, and why the auditor suspects that a gratuity was offered or received. Also, state whether the contractor is aware of the

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condition and, if so, include comments on the nature of corrective action taken or contemplated, including the adequacy of any repayments to the Government.

(2) Do not forward with the referral many copies of essentially duplicative documents from the contractor's records, such as expense vouchers. Instead, forward one or two representative samples of such records along with a listing of pertinent information such as names, dates, and amounts extracted from the records. All copies should be legible. If it is not possible to obtain a legible copy, state this fact in the referral and briefly describe the document.

(3) Send the referral to Headquarters, ATTN: OTS, with copies to the regional director. OTS will review the referral for possible forwarding to the appropriate investigative agency.

### **4-704 Suspected Violations of the Anti-Kickback Act (41 U.S.C. 51 to 58) \*\***

#### **4-704.1 General \*\***

a. The [Anti-Kickback Act](#) (4-7S1) prohibits providing, attempting to provide, or offering to provide any kickback; soliciting, accepting, or attempting to accept any kickback; or including, directly or indirectly, any kickback in the contract price charged by a subcontractor to a prime contractor or a higher-tier subcontractor or in the contract price charged by a prime contractor to the Government.

b. Kickback is defined as any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind which is provided, directly or indirectly, to any prime contractor, prime contractor employee, subcontractor, or subcontractor employee for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract.

#### **4-704.2 Examples of Questionable Practices \*\***

Questionable practices under the [Anti-Kickback Act](#) may take such form as: payments of commissions to prime contractor personnel; entertainment provided for prime contractor personnel; loans to prime or higher-tier contractor personnel that may not be repaid and may be later recorded as an expense on the subcontractor's records; and expensive gifts or preferential treatment to particular subcontractors.

#### **4-704.3 Audit Responsibilities \*\***

Ascertain that contractors have informed:

- (1) their personnel who award or administer subcontracts or purchase orders and
- (2) their subcontractors and suppliers about the provisions of the amended Anti-Kickback Act and questionable practices thereunder.

If such action has not been taken by a contractor, recommend that the contracting officer require such action. In addition, cooperate to the extent necessary to

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ensure that the contractor's procurement personnel are aware of the provisions of the Act.

### **4-704.4 Referral Requirements \*\***

Because Public Law 99-634, "[Anti-Kickback Enforcement Act of 1986](#)," imposes a duty on the contractor to promptly report the possible violation in writing to the Inspector General of the contracting agency, to the head of the contracting agency if the agency does not have an Inspector General, or to the Department of Justice, the contractor has a statutorily imposed duty to self-report. When there is reason to believe that a violation of the Act has occurred, and the cognizant Defense criminal investigative organization has not been notified, the auditor shall promptly prepare a DCAA Form 2000. The Form 2000 will state all known details of the transaction. Coordinate and forward the Form 2000 in the same manner as those on suspected fraud (see 4-702.4).

### **4-705 Suspected Anticompetitive Procurement Practices \*\***

a. Anticompetitive procurement practices are those designed to eliminate competition or restrain trade. They include those practices or events listed in [FAR 3.303\(c\)](#). They do not include bona fide sole-source procurement actions, violations of the Competition in Contracting Act by the procuring activity, or buying-in by a contractor.

b. If information received from any source indicates suspected anticompetitive procurement practices by a contractor or subcontractor, determine, by appropriate audit techniques, whether sufficient evidence exists to indicate an improper practice. If the anticompetitive procurement practice involves exclusive teaming arrangements, see 4-705c. For all other anticompetitive procurement practices, promptly submit a referral using the procedures set forth in 4-702.4.

c. When auditing a contractor's records, auditors may encounter, or receive from other sources, information constituting evidence or causing suspicion of an anticompetitive exclusive teaming arrangement. Because of the complexity of antitrust laws, the existence of an exclusive teaming arrangement does not necessarily mean an anticompetitive situation exists. An example of an anticompetitive exclusive teaming arrangement is when one company teams exclusively with another company which other potential offerors consider essential for contract performance. The potential for an antitrust violation is present only if one or a combination of the companies participating in an exclusive teaming arrangement is the sole provider of a product or service that is essential for contract performance, and the Government's efforts to eliminate the exclusive teaming arrangement are unsuccessful. Therefore, if the information received from any source indicates an anticompetitive exclusive teaming arrangement, the auditor should promptly notify the contracting officer. If the auditor believes the contracting officer's efforts to resolve an anticompetitive exclusive teaming arrangement are not successful, the auditor will consult with DCAA Headquarters General Counsel for further guidance.

### **4-706 Suspected Illegal Political Contributions \*\***

#### **4-706.1 The Statute \*\***

a. [Title 2 U.S.C. 441c](#), in essence, prohibits any firm or person contracting with the United States from making a contribution to or expenditure for a political party, committee, candidate for public office, or any person, for a political purpose or use. The statute applies only at the national level, not the state and local levels.

b. The term "contribution" includes:

(1) any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office; or

(2) the payment by any person of compensation for the personal services of another person which are given to a political committee without charge for any purpose.

#### **4-706.2 Methods of Channeling Inappropriate Expenditures \*\***

Corporations that make illegal political contributions may use several means to channel such payments to the intended recipient. Be alert to such methods as:

a. Bonus payments to contractor personnel passed on by the employee as a personal contribution or returned to the company to make the contribution. These payments usually cover taxes paid by the employee. Review carefully any bonus payments which might be based on a formula designed to cover taxes due.

b. Payments to outside consultants or other professional contacts. Such payments may be too high for the service received or there may be no services received at all. Scrutinize high or unusual professional and consultant service expenses for inappropriate expenditures. Such scrutiny involves a comprehensive review of supporting documentation, which should state the extent of services provided.

c. Padding or falsifying expenses paid to employees. Such expenses may include travel, dues, memberships and subscriptions, training, educational expenses, or any expenses where the contractor makes payment based on an invoice from an employee or a close, outside associate.

#### **4-706.3 Audit Responsibilities \*\***

It would be impractical to perform the audit effort necessary to disclose every illegal political contribution. However, government auditing standards require auditors to design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, abuse, illegal acts, or other unlawful activity that could significantly affect the audit objectives or results of audit (see 4-702.2a).

#### **4-706.4 Referral Requirements \*\***

When a violation of the statute is suspected, submit a report describing all known details of the transaction to Headquarters, ATTN: OIS, for possible referral to the Federal Election Commission. The [DCAAF 2000](#) may be used for this purpose.

## **4-707 DoD Contractor Disclosure Program \*\***

### **4-707.1 Introduction \*\***

The [FAR 52.203-13](#) - Contractor Code of Business Ethics and Conduct, requires contractors to timely disclose in writing, credible evidence of certain violations of Federal criminal law or the civil False Claims Act. The contractor's submission of disclosures has been termed the Contractor Disclosure Program within the Department of Defense (DoD), and replaces the predecessor DoD Voluntary Disclosure Program. This section provides guidance and procedures to be followed when DCAA receives a Contractor Disclosure.

### **4-707.2 Background Information \*\***

a. [Section 6102 of Public Law 110-252, Title VI, Chapter 1](#) "Close the Contractor Fraud Loophole Act," passed by Congress on June 30, 2008, directed the revision of the Federal Acquisition Regulation (FAR) to require inclusion of provisions that require timely notification by Federal contractors of violations of Federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts, including those performed outside the United States and those for commercial items.

b. [FAR 52.203-13](#) "Contractor Code of Business Ethics and Conduct," became effective December 12, 2008. This regulation is applicable to contracts and subcontracts expected to exceed \$5 million with a period of performance of 120 days or more. Major elements of this regulation include:

(1) Establishing the requirement for a contractor to make timely disclosure, in writing, to the agency Office of the Inspector General (OIG), with a copy to the Contracting Officer, whenever, in connection with the award, performance, or closeout of the contract or any subcontract thereunder, the contractor has credible evidence that a principal, employee, agent, or subcontractor of the contractor has committed:

(a) A violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S.C.; or

(b) A violation of the civil [False Claims Act \(31 U.S.C. 3729-733\)](#).

(2) Requiring certain contractors to establish business ethics awareness and compliance programs and internal control systems.

(3) Providing protection for the information being provided on the disclosure.

(4) Requiring that contractors provide full cooperation to the Government. This means that the disclosure must provide information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes providing timely and complete responses to Government auditors' and investigators' requests for documents and access to employees with information. However, the rule does not foreclose any contractor's rights arising in law, the FAR, or the terms of the contract. It does not:

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(a) Require a contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine;

(b) Require any officer, director, owner, or employee of the contractor, including a sole proprietor, to waive his or her attorney client privilege or Fifth Amendment rights; and

(c) Restrict a contractor from conducting an internal investigation or defending a proceeding or dispute arising under the contract, or related to a potential or disclosed violation.

c. The [FAR 52.203-13](#) enactment also led to amendments in other parts of FAR by creating additional causes for suspension or debarment actions against contractors (see [FAR 9.406-2\(b\)\(1\)\(vi\)](#) and [9.407-2\(a\)\(8\)](#)). Specifically, a contractor may be suspended or debarred, based upon a preponderance of the evidence, for knowing failure by a principal, until 3 years after final payment on any Government contract, to timely disclose:

(1) A violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S.C.;

(2) A violation of the civil [False Claims Act](#) (31 U.S.C. 3729-3733); or

(3) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in [FAR 32.001](#).

d. Contractors make a disclosure with no advance agreement regarding possible resolution of the matter and with no promises regarding potential civil or criminal actions by the Government.

### **4-707.3 Introduction\*\***

The Department of Defense revised [DoD Directive 5106.01](#) "Inspector General of the Department of Defense (IG DoD)" assigning the DoD Inspector General with the responsibility to serve as the initial point of contact within the DoD for Defense contractors and subcontractors to disclose potential civil or criminal fraud related matters that affect their contractual relationships with the DoD, and manage the DoD Contractor Disclosure Program. [DFARS 203.10](#) "Contractor Code of Business Ethics and Conduct" implements the program requirements for DoD. Defense contractors and subcontractors must submit the disclosure to the DoD Contractor Disclosure Program Manager, at the DoD Office of the Inspector General at the following address:

Office of the Inspector General of the Department of Defense

Investigative Policy and Oversight

Contractor Disclosure Program Management Office

4800 Mark Center Drive, Suite 11H25

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Alexandria, VA 22350-1500

E-mail Address: [disclosures@dodig.mil](mailto:disclosures@dodig.mil)

Information for contractors on the [DoD Contractor Disclosure](#) program is available online.

### **4-707.4 DCAA Responsibility \*\***

[DoD Instruction 5505.15](#), dated June 16, 2010, establishes policies and assigns responsibilities under the program. In accordance with this instruction, DCAA is assigned two specific responsibilities:

- a. Establish procedures to ensure any contractor disclosure received directly from a contractor is immediately forwarded to the OIG DoD.
- b. Provide audit support to the contracting officer, the OIG DoD, and the Defense Criminal Investigative Organizations (DCIOs).

### **4-707.5 DCAA Receipt of Contractor Disclosure Procedure \*\***

DCAA should only receive the DoD contractor disclosure from the OIG DoD - DoD Contractor Disclosure Program Management Office (DoD CDPMO). This office will provide the contractor disclosures directly to the DCAA Justice Liaison Auditor (JLA) at Headquarters – Operations. The JLA will be responsible for distribution to DCAA Regions and the cognizant FAOs. The FAO manager should immediately contact the JLA for assistance:

- a. Should a contractor, subcontractor, or its legal counsel provide a contractor disclosure under the DoD Contractor Disclosure Program directly to a FAO.
- b. Should a DoD contracting officer contact the FAO to request audit assistance with a contractor disclosure not previously received by the FAO.

The JLA will assist in determining whether the contractor has properly submitted the disclosure to the DoD CDPMO. If not properly submitted, the FAO manager should direct the contractor (by formal letter) to submit the disclosure to the DoD CDPMO. Furnish the DoD CDPMO, the JLA, and when applicable the contracting officer, a copy of any such correspondence. Under no circumstances are DCAA personnel to accept refund checks.

### **4-707.6 Processing of Contractor Disclosure – General \*\***

- a. The JLA will conduct an initial analysis of the contractor's disclosure to determine whether a formal action is required. Factors the JLA will consider include: the nature of the violation being disclosed; the impact or damage to the Government; the impact on current or future audit planning; and the potential that an audit or an assessment could impact ongoing criminal or civil investigations. The JLA will prepare a notification memorandum to the cognizant FAO manager, and attach a copy of the

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contractor disclosure. As soon as practicable, the FAO manager should review the submission to confirm the FAO has cognizance of the contractor and the contractor's books and records that support the contractor disclosure. Contact the JLA should the contractor disclosure need to be redirected to a different FAO.

b. Within 30 days of FAO receipt of the contractor disclosure, the FAO should complete the DCAA Disclosure Response (see example on Figure 4-7-6) and return it to the DoD CDPMO; copy the JLA and the cognizant RSI. The purpose of the DCAA Disclosure Response is to acknowledge the FAO's receipt of the disclosure, provide initial information regarding the disclosure (i.e., any prior knowledge/coordination of the disclosure), identify an FAO point-of-contact, and when required, provide an assignment number to document the disposition analysis (see 4-707.6c(2)). The DCAA Disclosure Response is required for each contractor disclosure. Upon receipt of the FAO's completed DCAA Disclosure Response, the DoD CDPMO may directly contact the FAO manager regarding the contractor disclosure. The FAO manager should respond directly to the DoD CDPMO, copying the JLA, with their response to the inquiries.

c. The JLA will classify each contractor disclosure as either: an Information Notification or an Action Required Notification. The following processes will be followed contingent on the type of notification received:

(1) Information Notification. An Information Notification requires no formal action (see example of an Information Notification Memorandum in Figure 4-7-7). However, if the FAO manager determines that a disposition analysis is needed, the FAO manager should immediately contact the JLA for coordination. In such circumstances, follow the same guidance as Action Required Notification below.

(2) Action Required Notification. Contractor disclosures not designated as an Information Notification will be designated as an Action Required Notification by the JLA (see example of an Action Required Notification Memorandum in Figure 4-7-8). Action Required Notifications will require the FAO manager to perform the following actions:

(a) Establish an assignment using DMIS Activity Code 17920. A separate assignment is to be established for each Action Required Notification in part to ensure the program's desired visibility and to serve as the collection point for the continued FAO's activity. Conduct a disposition analysis to determine the best course of action to address the disclosure. A disposition analysis is not an audit risk assessment. A disposition analysis differs from an audit risk assessment because it is less comprehensive in nature. An auditor may conclude after completing a disposition analysis that a detailed examination of the contractor disclosure is not necessary and that no further action is required based on the risk of the disclosure. The disposition analysis should consider coordination discussions with the cognizant contracting officer (e.g., ACO or PCO) as appropriate. Refer to 4-707.7d for suggested disposition analysis steps.

(b) After completion of the disposition analysis the FAO manager should issue a memorandum to the cognizant contracting officer documenting the results of the disposition analysis and when necessary include a statement as to the additional actions



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the FAO will pursue as a result of the contractor's disclosure. Furnish the DoD CDPMO, the JLA, and RSI a copy of the memorandum. Timely actions will increase the program's success. Therefore, the FAO should complete the disposition analysis and issue the memorandum generally within 60 days after the disclosure is received. Exceptions to the 60 day requirement may include when a contractor makes a preliminary disclosure (see 4-707.7c), when a criminal or civil investigator requests that any actions be postponed due to a pending investigation (see 4-707.8a), or when an FAO has higher work priorities. Other exceptions may be coordinated with the JLA.

(c) The memorandum documenting the results of the disposition analysis should reference the applicable contractor disclosure number on the subject line.

d. All contractor disclosures should be annotated in the Electronic Contractor Permanent File, folder B-06 Audit Leads and should be considered, where applicable, in the risk assessment when planning the scope of future audits.

### **4-707.7 Guidance on Action Required Notification [\\*\\*](#)**

A contractor disclosure received from the JLA as an Action Required Notification should be considered as high audit risk due to the contractor's disclosure of credible evidence of fraud and its potential damage to the Government. For this reason, the FAO should give priority to any required action. An auditor may conclude that a contractor disclosure is other than high risk only after the completion of a disposition analysis. A documented disposition analysis will ensure our audit resources are efficiently used while fulfilling our audit responsibilities under the program.

a. Some examples of criteria for assessing the risk of a contractor's disclosure while performing a disposition analysis may include:

- (1) the nature of the subject matter disclosed,
- (2) financial or monetary degree of damage to the Government,
- (3) prior significant deficiencies noted on the relevant control environment, and
- (4) the contractor's degree of compliance with the Contractor's Code of Business Ethics and Conduct Program (see CAM 5-306).

b. The extent of the disposition analysis documentation will depend on the auditor's judgment, keeping in mind that audit resources should be focused on those areas of highest risk. Auditors must use their professional judgment when determining what actions to take.

c. Auditors should also be alert for any contractor preliminary disclosures submitted under the DoD Contractor Disclosure Program. [FAR 52.203-13](#) does not restrict the contractor from examining or investigating the incident internally to determine whether the evidence is credible (see 4-707.2b(4)(c)). There are instances in which the contractor will choose to disclose the violation to the DoD CDPMO, prior to completing an

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internal investigation to conclude the nature and extent of the incident. Typically these preliminary disclosures lack the clarity with respect to the underlying facts. Auditors should determine if the contractor is planning or is in the process of performing an internal investigation prior to expending significant FAO resources. Auditors may postpone any further action and defer the disposition analysis until the contractor has completed its internal investigation and has submitted to the DoD CDPMO an updated disclosure documenting the results of the investigation. Notify the JLA that the assignment is being delayed pending receipt of the final disclosure. The disposition analysis should document this interim decision.

d. Consider the internal controls in relation to the contractor's disclosure process and assess control risk. CAM 5-100 may be used to obtain a general understanding and assess control risk. Additional disposition analysis steps may include the following:

(1) Through discussion, inquiries, understanding of the matters disclosed, and a review of the contractor's permanent files, the auditor should have a general understanding of:

(a) how the contractor discovered the disclosed matters;

(b) the contractor's methodology for quantifying the cost impact;

(c) whether the contractor took corrective actions in accordance with the contractor's business ethics awareness and compliance program;

(d) whether the disclosed subject matter is an isolated incident or appears to be systemic in nature, i.e., significant deficiencies or material weakness. For example, has the contractor made several disclosures representing a pattern of possible systemic concerns, i.e., has the contractor submitted individual disclosures for numerous instances of labor mischarging at a single contractor facility covering the same time periods?

(e) whether the contractor appears to have included all directly associated costs and related burdens;

(f) whether the contractor appears to have removed expressly unallowable costs associated with the incident, (see [FAR 31.205-15](#)); and

(g) whether the contractor made or is planning to make a refund or credit to the Government and if a refund or credit was made, verification that the Government received the contractor calculated amount.

(2) Identification of completed or in-process audits related to the disclosure;

(3) Determination of the impact on currently planned and in-process audits that may be affected by the disclosed issue; and

(4) Coordination with the contracting officer and when necessary with other Program Stakeholders (i.e., criminal investigators, Government attorneys, etc.) to discuss

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particular concerns.

e. While materiality is an important factor during the documentation of the disposition analysis, auditors should avoid using solely a predetermined dollar threshold to determine actions required. A dollar threshold implies an arbitrary assessment based exclusively on the monetary impact rather than the nature of the individual disclosure, especially on matters when other risks are present. For example, an individual disclosure may not reflect the risk that controls may not exist or the risk that the contractor's controls in place will not prevent or detect future incidents on a timely basis.

f. The documentation of audit leads may provide the desired visibility and may be appropriate to conclude the disposition analysis. The Audit Lead sheet preparation and documentation requirements are discussed in 4-403e(4). The final approved audit lead sheet should be attached to the memorandum issued to the contracting officer documenting the completion of the disposition analysis.

g. Coordination with the contracting officer (e.g., ACO or PCO) is essential for the program's success. The DoDI 5505.15 assigns the responsibility to DoD components, except DCAA, to determine whether administrative remedies are necessary when a disclosure is made. Therefore, all actions should be coordinated with the cognizant contracting officer.

h. When an examination of the disclosure is the best course of action as a result of the disposition analysis; the auditor should expand the disposition analysis and conduct an audit risk assessment to establish the scope of audit efforts using the established 17920 assignment. Auditors should not issue a separate memorandum to the contracting officer documenting the results of the disposition analysis, instead the auditor should communicate the commencement of an audit using an acknowledgment letter to the contracting officer. Furnish the DoD CDPMO, the JLA, and RSI a copy of this acknowledgment letter. Reference the applicable contractor disclosure number on the subject line of the acknowledgment letter (see CAM 4-104 for the content and format of an acknowledgment letter). The examination will focus on matters disclosed by the contractor and, at a minimum, should include a verification of the completeness and accuracy of the disclosed matters, including any disclosed monetary impact to the Government and whether the contractor made or is planning to make a refund or credit to the Government and if a refund or credit was made, verification that the Government received the contractor calculated amount. Audit reports should reference the applicable contractor disclosure number and be addressed to the cognizant contracting officer. Furnish the DoD CDPMO, the JLA, and RSI a copy of the audit report. Prepare the audit report using the format in CAM 10-1200 making certain that all relevant issues are covered. Do not hesitate to expand the report in the interest of clarity. The FAO can complete audit effort for a number of contractor disclosures under one assignment, ensuring that results are clear and easy to understand for the intended user of the information.

### **4-707.8 Investigative Support on DoD Contractor Disclosure Program \*\***

DCAA responsibility includes providing support to Defense Criminal Investigative

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Organizations (DCIOs) (see 4-707.4b). Support to DCIO's will typically be provided by the Regional Investigative Support Divisions as part of the DoD Contractor Disclosure Program. Investigative support responsibilities are discussed in 4-702.6.

a. FAOs have primary responsibility for reviewing contractor disclosures referred to them for action. FAO managers are expected to complete required effort regarding contractor disclosures irrespective of any pending investigations or investigative support being provided by the Regional Investigative Support Divisions. However, should an FAO manager be contacted by a criminal or civil investigator with a request to postpone or stop their audit efforts to avoid compromising a pending or open investigation, the FAO manager should immediately coordinate the action with the JLA. Audit effort will be postponed or stopped at the request of a criminal or civil investigator or a U.S. Government attorney. The FAO manager should take no actions that would compromise the investigation. If it is believed the requested deferral will cause financial harm to the Government or unnecessarily impede the audit mission, elevate the matter for management resolution between the respective organizations. Before any decision is made to defer or suspend an audit, coordinate the matter with the JLA.

b. If contacted by DoD investigators or Government attorneys for assistance on contractor disclosure matters, Regional Investigative Support Divisions should avoid duplication of efforts and determine if the cognizant FAO may have audits in-process or may have completed any audit efforts that will meet the agent or attorney's request.

### **4-707.9 Other Special Considerations \*\***

a. Contractor disclosures should not be disseminated outside of DCAA without the prior approval of the DoD CDPMO.

b. When performing an examination of the contractor disclosure, auditors should follow communication requirements with the contractor and contracting officials discussed in 4-100 and 4-300. However, if an auditor becomes aware that the audit relates to any pending criminal or civil investigations, the auditor will coordinate, through the cognizant Regional Investigative Support Division, with the DCIO to determine whether any of the audit results or working papers should be first provided to the investigators. The auditor must also determine whether the DCIO will restrict or limit discussions during an exit conference to avoid compromising the ongoing investigation.

c. Contractor cooperation is essential to timely and effective completion of any audit effort. The FAO manager should promptly notify both the DoD CDPMO and the JLA when the contractor fails to cooperate fully as required by [FAR 52.203-13](#) (see 4-707.2b(4)(c)); this will afford an opportunity to resolve the matter before any action to formally report a denial of access to contractor records. If the DoD CDPMO efforts are unsuccessful in resolving the matter, the FAO manager should consider the contractor's lack of cooperation in supporting their disclosure as a denial of access to contractor records and follow the procedures in [DCAA Instruction 7640.17](#), Formal Reporting Procedures for Denial of Access to Contractor's Records. When contractors assert attorney-client privilege, or attorney-work-product doctrine, auditors should observe procedures discussed in CAM 1-504.4g. The FAO manager should consider whether

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the contractor's unsatisfactory cooperation impacts the contractor's current control environment and contractor responsibility for performance on Government contracts (see CAM 5-306.3).

d. Immediately coordinate with the contracting officer, DoD CDPMO, and JLA any significant findings or concerns identified during the disposition analysis or audit of the contractor disclosures. If submitting a DCAAF 2000 to the JLA related to suspected irregular activities not previously disclosed, but related to the contractor's disclosure, identify the related contractor disclosure number on the referral. Procedures for reporting Suspected Irregular Conduct (e.g., DCAAF 2000) are discussed in CAM 4-702.4.

### **4-708 Obstruction of Audit \*\***

a. The [Anti-Drug Abuse Act of 1988](#) (P.L. 100-690) added section 1516 to Title 18, U.S.C., which contains an obstruction of audit provision. This provision makes it a crime for a person or corporation to endeavor to influence, obstruct, or impede, with the intent to deceive or defraud the Government, a Federal auditor in the performance of official duties. The purpose of the provision is to punish acts designed to prevent an auditor from discovering or reporting fraud or deceit against the Government. The provision does not make it a crime to deny an auditor access to records unless the purpose of the denial is to prevent such discovery. Therefore, do not report a suspicion of fraud or other unlawful activity solely on the basis that access to records was denied. Pursue access to records problems in accordance with CAM 1-504.5.

b. If there is a reasonable basis to suspect fraud or deceit against the Government and you believe a denial of access to records is an attempt to prevent an auditor from discovering or reporting this fraud or deceit, include this information in a suspected fraud referral (see 4-702.4). The mere denial of access to records, however, is not by itself a reasonable basis to suspect fraud.

c. When reporting suspicions of fraud or other unlawful activity (see 4-702.4), include any information on suspected contractor efforts to influence, obstruct, or impede an auditor with the intent to deceive or defraud the Government.

### **4-709 Qui Tam Actions Under the False Claims Act \*\***

Qui tam actions are civil, not criminal, actions, which are brought under the authority of the False Claims Act. In such a suit, the plaintiff brings the action on behalf of the Government. A qui tam suit is filed under seal. The defendant contractor is not provided with a copy of the filing nor is it to be told the contents of the filing while the action is under seal. The Government is furnished a copy of the filing and has 60 days in which to make a decision on whether it will join in the suit. To assist its deliberations, the DOJ will frequently seek information about the defendant contractor from DCAA. Information in our files and working papers is to be made readily available to the attorney handling the case as well as any DoD personnel supporting the attorney. Any requests for additional audit support will be treated as a customer requested

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assignment. The contractor is not to be informed of the source of these requests without the approval of the requesting attorney. At the same time, the FAO should determine if the attorney has any objections to providing the results of the audit to the contracting officer. If there are none, a report should be sent to the contracting officer. However, the report will caution that the audit was conducted in connection with a qui tam suit and that before any contractual action is taken on the matter, permission must be obtained from the responsible attorney.

### **4-710 Defense Hotline \*\***

a. The [Defense Hotline](#) is an element of the DoD Inspector General Office of Investigations which receives and reviews audit and investigative leads. The Defense Hotline operates to ensure that allegations of fraud and mismanagement are properly evaluated, substantive allegations are examined, appropriate administrative, remedial or prosecutive actions are taken and administrative procedures are in place and maintained in order to properly manage Hotline allegations. It receives allegations from Government entities such as DoD, from private individuals both inside and outside the Government, and from the GAO. The Hotline assigns review of these leads to the audit or investigative agency it believes is best qualified to determine their validity; monitors the progress of the examination; reviews and analyzes all interim and final reports to determine that the examinations are conducted properly and the appropriate corrective measures were recommended and/or taken; and tabulates and reports case dispositions. DoD instructions pertaining to the [Defense Hotline](#) program are discussed in DoDD 7050.1. DCAA responsibilities for reviewing Hotline referrals are set out in [DCAAI 7600.1](#).

b. In accordance with DoD IG Joint Policy Memorandum Number 95-2 dated May 26, 1995, the DoD Hotline reviews will only be performed by individuals and organizations who are independent. Accordingly, non-government employees and/or organizations, including contractor internal audit groups or external auditors, will not perform any work in relation to any DoD Hotline review because of their inherent lack of independence.

c. The Hotline and the Agency are obligated to protect the anonymity of sources. The Headquarters, DCAA transmittal of a sensitive Hotline referral will make specific reference to nondisclosure requirements in its opening paragraph. Hotline documents arising from such a source are clearly marked. In order to evaluate a Hotline referral, it may be necessary to advise a contractor that an audit lead has been received. However, the auditor should strive to reveal only the minimum amount of information necessary to conduct a proper and thorough review. The Hotline should not be identified as the source of the lead. Under no circumstances may Hotline documents be released outside the Government. Hotline documents may be released within Government channels only to agencies/employees involved in the Hotline review.

d. At its discretion, the Hotline may determine that an allegation lacks significant detail or significant subject matter to warrant formal inquiry. Such a matter will be classified as an information referral. All other referrals are action referrals which are

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assigned a due date. Hotline referrals are reviewed in Headquarters, OTS, and are forwarded to the cognizant regional office for information or response. The regional office may further delegate responsibility. Delegation of the decision to conduct a field review of an information referral does not convert the status of that referral to an action referral. However, if a field audit is undertaken, results must be reported to the Hotline.

e. All Hotline referrals which have been assigned due dates, either by the Hotline or by Headquarters, are to be treated as customer requested assignments. If a due date cannot be met, an extension should be requested by filing a Hotline Progress Report ([DCAAI 7600.1](#)). The Hotline has suggested that six month extension requests reduce unnecessary proliferation of progress reports. It is the responsibility of the Regional Office to assure that Hotline progress and completion reports are issued in the specified format.

f. When a field audit of a Hotline referral involving alleged fraud is undertaken, allegations are to be treated as audit leads and followed up through audit in accordance with 4-702.2c. If a reasonable suspicion of fraud or other unlawful activity remains after performing the appropriate risk assessment and audit steps, arrangements should be made for transfer of the matter to an investigative agency. The responsible field element should discuss the case with the investigative office to which it would have sent a DCAAF 2000 had the allegation arisen through audit. (However, matters first reported through the [Defense Hotline](#) are deemed to be known to the Government, and therefore ineligible for reporting on the DCAAF 2000.) Case responsibility may be transferred by submitting a Hotline Completion Report (DCAAI 7600.1) to Headquarters, Attention OTS, setting out the results of audit, the reason(s) for transfer, and the investigative office to which the matter should be transferred.

g. Audit procedures and reporting following transfer of a Hotline referral to an investigative agency should be carried out in accord with 4-702.5. If a transfer is not made, audit findings should be pursued and reported in accord with normal procedures. If available, audit reports containing findings and recommendations which arose from a Hotline referral should be submitted as an enclosure to the Hotline Completion Report.

h. When a referral makes allegations of a technical nature, the assistance of a Government technical evaluator should be obtained. Occasionally it becomes apparent that the technical evaluator's agency should assume responsibility for the referral, with audit support as needed. When this happens, transfer of responsibility should be formalized similarly to investigative transfer.

### **4-711 Evaluating Contractor Compliance with Administrative Suspension and Debarment Agreements \*\***

a. Background. Contractors found to have committed fraud or other misconduct sometimes enter into suspension and debarment agreements to avoid being suspended or debarred from obtaining Government contract awards or to be removed

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from the listing of suspended or debarred companies. These agreements usually require the contractor to implement ethics and fraud prevention programs and strengthen internal controls over the areas where the fraud or other misconduct occurred. Often, the agreements require the contractor to maintain a Hotline for employees to report fraud or other irregularities. Sometimes the costs incurred by the contractor to comply with these agreements are unallowable under [FAR 31.205-47](#). Each Service and the Defense Logistics Agency has suspension and debarment officials or designees who are responsible for monitoring contractor compliance with the agreements.

b. Responsibilities. The suspension and debarment officials or designees will request DCAA audit support to evaluate contractor compliance with any provisions of the agreement that relate to DCAA's audit mission. For example, the auditor will generally be requested to perform an audit if the contractor is identifying and segregating the unallowable costs being incurred to comply with the agreement. If the agreement also provides for the contractor to make improvements to its internal control systems, the auditor will generally be requested to determine if the improvements have been made. The suspension and debarment officials or designees are responsible for assessing overall contractor compliance with the agreement.

c. Briefing of the Agreement and Coordination. At those contractors with suspension and debarment agreements, the FAO should obtain a copy and brief the agreement to identify provisions that fall within DCAA's areas of responsibility. The FAO should then discuss with the responsible suspension and debarment official or designee and the contracting officer the audit services needed to assist in evaluating contractor compliance. Any differences of opinion between the FAO and the suspension and debarment official or designee or any difficulty in arranging a meeting should be communicated through the Regional Office to PPS for resolution. The results of this coordination should be documented in the FAO's audit planning files.

d. Audit Planning. The FAO normally will not have to establish special audits to provide the needed audit support. The audit steps needed to assist the suspension or debarment official or designee in determining compliance with the provisions of the agreement can be usually performed as part of the FAO's regularly scheduled audits; e.g., the FAO's planned audits of internal controls relating to the identification and segregation of unallowable costs. However, if the compliance officer requests a special audit because of his scheduled responsibilities, the FAO should provide the requested services.

e. Corporate Offices. Settlements at the corporate level affecting two or more segments should be coordinated by the corporate auditor or CAC. After the briefing, the corporate auditor or CAC will disseminate the agreement to the segment auditors with an assist audit request (if applicable) on any services needed to assess compliance with the relevant parts of the agreement.

f. Reporting. The FAO should communicate in writing all noncompliances or other concerns with the agreement to the ACO cognizant of the contractor with a copy to the



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suspension and debarment official or designee. All applicable DCAA audit reports should contain comments on any contractor actions required by a suspension/debarment agreement until the contractor fully implements or complies with the agreement.

g. Excluded Parties Listing. The General Services Administration (GSA) maintains an "Excluded Parties Listing System" in the [System for Award Management](#), which provides data on all suspended and debarred parties. If you are accessing System for Award Management (SAM) from a government computer network, you automatically have access to Entity Management For Official Use Only (FOUO) data, so DCAA users do not need to register for an account. The site allows data searches via various search criteria, makes available a number of reports in different formats, and provides other useful data. This information is updated continuously. This site is the only source that should be used when checking the suspensions and debarment status of a contractor. A complete user's manual for [SAM](#) is available.

### **4-7S1 Supplement - Public Law 99-634, Anti-Kickback Enforcement Act of 1986 \*\***

An Act to prohibit kickbacks relating to subcontracts under Federal Government contracts.

[Anti-Kickback Enforcement Act of 1986](#)

#### **Figure 4-7-1 \*\***

### **Pro Forma Cautionary Transmittal Memorandum**

MEMORANDUM FOR (name and address of requestor)

SUBJECT: Cautionary Statement Related to Audit Report (audit report number, date and subject, and the contractor's name and location)

The attached audit report addresses certain matters which have raised a suspicion of potential fraud on the part of (indicate the name of the company involved). Specifically, those matters are (provide a brief description of the suspected irregular conduct). We are willing to discuss these matters with you, your counsel, and representatives of the cognizant criminal investigative organization in an effort to reach a proper disposition of these issues in light of the requirements of DoD Instruction 7050.05, Coordination of Remedies for Fraud and Corruption Related to Procurement Activities.

(Signature)

Branch Manager

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Figure 4-7-2 \*\*

**Suspected Irregularity Referral Form**

**(Use full size form or APPS Version for reporting)**

**DCAA CASE NO.:** \_\_\_\_\_

**SUSPECTED IRREGULARITY REFERRAL FORM**

Follow enclosed guidance and DCAA Instruction 7640.15 when providing the following information:

1. Name, FAO, RORG number, telephone and FAX numbers, and e-mail address of the auditor preparing the referral.
2. Contractor's name, division, and address. Identify if the contractor is a small/disadvantaged (8a) firm.
3. Government entities (e.g. Navy, DOE, HHS, etc.) affected by irregularity. If possible, identify contract(s), types, amounts, and major program(s) affected.
4. Classification of irregularity (See the enclosed instructions)
5. Prepare, on a separate page, a concise description of the irregularity. Include the following criteria: **who, what, where, when, how, how much**. If possible, identify regulatory provisions and/or statutes violated. Attach documentation (appropriately cross-referenced) as necessary.
6. Reason for treating this as other than normal questioned costs (e.g.; if suspected fraud, where is the **material statement**, which is **false**, and why do you think it is **known** by the maker to be false?)
7. Estimated loss or impact to the Government. Explain basis and any reasons for limited current visibility of total losses.
8. Signature of Auditor and date (must be signed and dated).

---

Auditor

Date

Distribution: Headquarters OIS (DCAA-JLA@dcaa.mil) and ACO/PCO, (see also CAM 4-702.5(f))(See DCAAI 7640.15 and CAM 4-702.4).

*INSTRUCTIONS FOR PREPARATION OF FORM 2000*

**GENERAL:**

Information which suggests a reasonable basis for suspicion of fraud, corruption, or unlawful activity affecting Government contracts must be reported promptly. For reporting purposes, fraud is defined as: a material statement of fact which is false, and known to be false. Other reportable irregularities include Kickbacks, Gratuities, Illegal Political Contributions, Foreign Corrupt Practices Act violations, and Agreements in Restraint of Trade. Activities not reportable on the Form 2000 include matters such as (1) those already known by the Government, (2) Contractor Disclosures, and (3) unsatisfactory conditions (CAM 4-800).

An effective referral requires close communication between auditors, supervisors and FAO Managers. You may also coordinate with DCAA Investigative Support (OIS) if there are any questions about whether or not to refer the matter, keeping in mind the need for promptness. Follow instructions in CAM 4-700 and DCAAI 7640.15 in preparing the Form. Use continuation pages as necessary, especially for question 5, keeping in mind the need for conciseness.

**Classification of Irregularity (Form 2000, Item 4):**

To assist the investigator in evaluation of the material presented, indicate in item 4 which of the following classifications best fits the matter being referred (more than 1 classification may apply):

<p>1. Defective Pricing</p> <p>a. Pattern of Activity</p> <p>b. Other (explain)</p>	<p>5. False Claims/Certifications</p> <p>a. Equitable Adjust. Claims</p> <p>b. Termination Settlements</p> <p>c. Indirect Cost Certification</p> <p>d. Other (explain)</p>	<p>8. Ethical Violations</p> <p>a. Kickbacks</p> <p>b. Gratuities</p> <p>c. Political Contributions</p> <p>d. Foreign Corrupt Practices Act</p> <p>e. Bribery</p> <p>f. Restraint of Trade</p> <p>g. Other (explain)</p>
<p>2. Billing Irregularities</p> <p>a. Progress Payments</p> <p>b. Public vouchers</p> <p>c. Other (explain)</p>	<p>6. Consultants/Subcontractors</p> <p>a. Consulting Irregularities</p> <p>b. Subcontract Irregularities</p>	
<p>3. Labor Irregularities</p> <p>a. Timekeeping</p>	<p>7. Materials</p>	<p>9. Other Irregular Activity</p>

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b. IR&D/B&P Mischarges c. Other (explain)	a. Product Substitution b. MMAS c. Other (explain)	a. Conspiracy b. Obstruction of Audit (see CAM 4-708) c. Other (explain)
4. Accounting Mischarging a. FAR 31/CAS 405 Violations b. Improper Transfers c. Unallocable Costs d. Other (explain)		

DCAAF 2000

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**Figure 4-7-3 \*\***

**Examples of Characteristics and Types of Activity Associated with Illegal Expenditures and Acts for Specific Audit Areas**

Audit Area	Indicators
Labor	Unexplained changes to timecards transferring hours from commercial firm-fixed-price contracts to Government cost-type contracts.  Employee time charged differently from associated travel costs.  Diverting labor from firm-fixed-price contract by reclassifying employees as indirect who provide direct labor to firm-fixed-price contracts.
Material	Significant material requirements charged to Government cost-type contracts where follow-up work shows that the material was not needed.  Using inferior material on Government contracts that does not meet contract specifications.

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False certification of inspection test results.

Subcontracts Intercompany profit claimed and billed for an intercompany affiliate that the contractor represented to the Government was an unrelated subcontractor.

Indirect Cost Overrun contract costs charged to indirect expenses for allocation to other contracts.

Expressly unallowable costs recorded in accounts that are generally allowable such as small tools and supplies.

Improper transfers, or recording, of costs to indirect accounts for direct contract costs that are not allowed to be charged under the terms of the contract.

Defective Pricing See 14-121.2 for listing.

All Audit Areas Alterations to documents that would result in improper costs claimed for Government contracts.

Evidence showing that payments were not actually made for the amounts shown on the document.

**Figure 4-7-4 \*\***

**Example of a DCAA Disclosure Response**

**(Due within 30 Days)**

**DEPARTMENT OF DEFENSE CONTRACTOR DISCLOSURE PROGRAM DCAA  
DISCLOSURE RESPONSE**

**CONTRACTOR DISCLOSURE NUMBER 20XX-0XXX (Contractor XYZ): (Action  
Required Notification/Information Notification)**

(Respond Y or N to the following statements)

\_\_\_\_\_The Contracting Office has coordinated with DCAA regarding this disclosure.  
If yes, please identify contracting officer and provide contact information

---

\_\_\_\_\_The Contractor has coordinated with DCAA regarding this disclosure.

\_\_\_\_\_DCAA Field Audit Office (FAO) was already aware of the contractor

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identified issue and has either submitted or is considering submitting a DCAA Form 2000 regarding the issue(s) in this disclosure. If a Form 2000 was issued, indicate the DCAA case number:

---

FAO: DCAA – FAO Address

FAO Point of Contact for Disclosure Issue: \_\_\_\_\_

POC Phone Number: \_\_\_\_\_

POC E-mail: \_\_\_\_\_

Assignment Number (if applicable): \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_ Phone Number: \_\_\_\_\_

Return to:

Department of Defense Office of the Inspector General

Investigative Policy and Oversight

DoD Contractor Disclosure Program Management Office

Email Address: disclosures@dodig.mil

Copy Furnished:

DCAA JLA

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**Law Enforcement Sensitive**

**Figure 4-7-5 \*\***

**Example of an Information Notification Memorandum to the FAO Manager**

MEMORANDUM FOR BRANCH MANAGER/RESIDENT AUDITOR, FAO

ATTENTION: Mr./Ms. Branch Manager/Resident Auditor

SUBJECT: Information Notification of Contractor Disclosure 20XX-0XXX Contractor XYZ

As part of the Contactor Disclosure Program administered by the Department of Defense Inspector General (DoDIG), we received contractor disclosure 20XX-0XXX

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(Enclosure 1) for Contractor XYZ, which we understand is under the cognizance of your office. The contractor disclosed.

The contractor disclosure is forwarded to your office for your information and use. You are not required to take action on contractor disclosure 20XX-0XXX. However, if you decide action on the contractor disclosure is warranted, immediately coordinate these actions with the JLA. Follow the guidance discussed in CAM 4-707.

Also, please complete the "DCAA Disclosure Response" (Enclosure 2) providing the key information that the DoDIG has requested. Please forward the completed form to the DoDIG with a copy to DCAA Justice Liaison Auditor (JLA) and the cognizant Regional Investigative Support Division within the next 30 days.

Finally, the contractor disclosure should be annotated in the Electronic Contractor Permanent File, folder B-06 Audit Leads.

Questions on this memorandum may be directed to the DCAA JLA.

Assistant Director, Operations

Enclosures: 2

1. Contractor Disclosure 20XX-0XXX
2. DCAA Disclosure Response

Copy furnished:

RD

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**Figure 4-7-6\*\***

### **Example of an Action Required Notification Memorandum to the FAO Manager**

MEMORANDUM FOR BRANCH MANAGER/RESIDENT AUDITOR, FAO

ATTENTION: Mr./Ms. Branch Manager/Resident Auditor

SUBJECT: Action Required Notification of Contractor Disclosure 20XX-0XXX  
Contractor XYZ

As part of the Contactor Disclosure Program administered by the Department of Defense Inspector General (DoDIG), we received contractor disclosure 20XX-0XXX

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(Enclosure 1) for the Contractor XYZ, which we understand is under the cognizance of your office. The contractor disclosed that a former employee, Mr. John E. Doe, charged 500 hours to a Government contract for time he did not work.

After your review of the contractor disclosure, set-up an assignment, using DMIS Activity Code 17920 and perform a disposition analysis. Follow the guidance discussed in CAM 4-707.

Also, please complete the “DCAA Disclosure Response” (Enclosure 2) providing the key information that the DoDIG has requested. Please forward the completed form to the DoDIG with a copy to DCAA Justice Liaison Auditor (JLA) and the cognizant Regional Investigative Support Division within the next 30 days.

Finally, the contractor disclosure should be annotated in the Electronic Contractor Permanent File, folder B-06 Audit Leads.

Questions on this memorandum may be directed to the DCAA JLA.

Assistant Director, Operations

Enclosures: 2

1. Contractor Disclosure 20XX-0XXX
2. DCAA Disclosure Response

Copy furnished:

RD

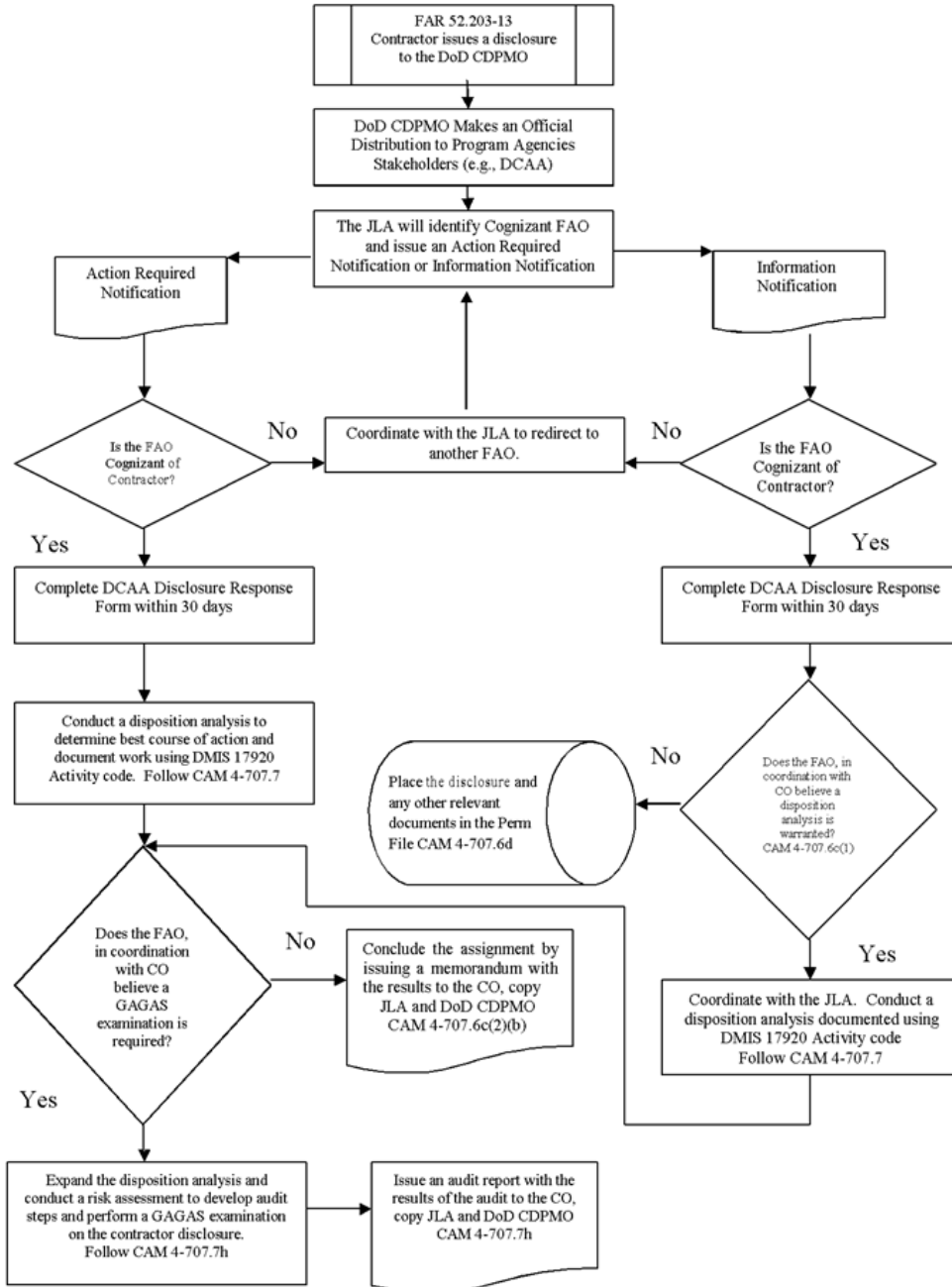
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**Figure 4-7-7 [\\*\\*](#)**

**DCAA Contractor Disclosure Process and FAO Decision Tree**





**Section 8 - Special Reporting of Unsatisfactory Conditions \*\***

**4-801 Introduction \*\***

This section contains guidance and procedures on special reporting requirements on unsatisfactory conditions noted by contract auditors that are not reportable under section 7 of this chapter.

**4-802 Voluntary Refunds for "Windfall Profits" \*\***

#### **4-802.1 Introduction\*\***

[DFARS Subpart 242.7100](#) expresses DoD policy and general procedures on the solicitation or acceptance of voluntary refunds from contractors or subcontractors.

#### **4-802.2 Audit Responsibility – Voluntary Refunds \*\***

When the contract auditor reaches a conclusion pursuant to 4-802.3 that it may be appropriate to seek a voluntary refund, the auditor should observe [DFARS Subpart 242.7100](#) carefully, and inform the cognizant administrative contracting officer, in writing, of this conclusion and its basis, either in an audit report or otherwise.

#### **4-802.3 Audit Procedures \*\***

On audits of any type, auditors should be alert to situations where the Government was overcharged under a contract; was inadequately compensated for the use of Government-owned property, or in the disposition of contractor inventory; and where the contractor's or subcontractor's retention of the amount in question would be contrary to good conscience and equity. If any of these situations are disclosed and it is due, at least in part, to the fault of the contractor or subcontractor, the Government may request a voluntary refund or credit, provided the adjustment is not otherwise required by contractual terms or statutory requirements such as 10 U.S.C. 2306a.

#### **4-802.4 Audit Reports \*\***

a. Prepare reports on situations involving voluntary refunds in a narrative format pursuant to CAM 10-1200. A decision to seek a voluntary price adjustment must be approved by the head of the contracting activity, or as provided in department/agency regulations. Therefore, the report or letter should contain sufficient information to permit adequate consideration of the facts and to support a decision at that level.

b. Address a report or letter involving a subcontractor to the contracting officer and forward it through the office which has audit cognizance of the prime contractor. Where audit cognizance has not been established for the prime contract and the prime contractor is not otherwise subject to audit by another audit office, transmit the report directly to the contracting officer in the same manner as if it involved a prime contract.

### **4-803 Unsatisfactory Conditions (Serious Weaknesses, Mismanagement, Negligence, etc.) on the Part of Contractors \*\***

#### **4-803.1 Introduction \*\***

a. Unsatisfactory conditions, such as repeated and significant deficiencies in accounting or estimating practices, mismanagement or negligence, and failure to comply with acquisition regulations may result in significant monetary loss or cost to the Government, or frustrate public policy.

b. Unsatisfactory conditions are not to be reported on the [DCAAF 2000](#). Denial of access to records ([DCAAI 7640.17](#)) is an unsatisfactory condition for which a specific remedy (the DCAA subpoena) is available. Neither suspected irregular conduct nor

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denial of access to records is reportable under this section.

c. Unsatisfactory conditions related to a Government official are discussed in 4-804 below.

### **4-803.2 Examples of Questionable Practices \*\***

Examples of unsatisfactory conditions in contractor operations include, but are not limited to, the following:

(1) An estimating system and related practices so deficient that price proposals are consistently unreliable, resulting in widespread defective pricing.

(2) Significant and chronic violations of Cost Accounting Standards.

(3) Internal control weaknesses of a magnitude that could cause significant monetary loss to the contractor and excessive cost to the Government.

(4) Excessive or premature contractor reimbursement because of inappropriate application or review of economic price adjustment provisions.

(5) Failure to pay the minimum wages required by the [Davis-Bacon Act](#), [Walsh-Healey Public Contract Act](#), or the [Service Contract Act](#).

### **4-803.3 Audit Responsibilities \*\***

a. Serious weaknesses causing major audit problems encountered during audit performance should be discussed with the contractor, the principal cognizant ACO, and the CAC as soon as possible so as to expedite the resolution process. The auditor should not wait until the final exit conference or the issuance of the audit report to convey such findings. All such discussions should be documented by appropriate memorandums or notations in the working papers and a separate audit report issued using the procedures in CAM 10-400, CAM 10-800, or CAM 10-1200.

b. When an unsatisfactory condition is called to the FAO manager's attention in writing, the FAO manager may:

- determine that no action is required;
- take appropriate action to resolve the condition; or
- determine that the condition cannot be resolved at the FAO level and request regional assistance.

The FAO manager should prepare a memorandum for record documenting judgments and conclusions supporting the choice of alternative. A copy should be furnished to the originator, with an information copy to the RAM, and the original report and the resulting MFR should be retained within an appropriate FAO file.

#### **4-803.4 Headquarters Reporting Requirements \*\***

a. When an FAO encounters unsatisfactory conditions in contractor operations and the issue cannot be resolved at the FAO level, the FAO should involve the regional office promptly.

b. If the condition is not or cannot be corrected after all FAO and regional office efforts have been exhausted, the regional office will prepare a Headquarters report describing the condition along with the actions taken to correct it and submit it to Headquarters, ATTN: Policy and Plans. It is important that the information forwarded to Headquarters is complete and has been reviewed by the Regional Director. Incomplete submissions will be returned to the Region for additional action and result in delaying the resolution of the condition. The following are examples of items to include in the submission to Headquarters; however, it is not an all-inclusive list:

- Audit Reports and/or other documents related to the unsatisfactory condition (to include monetary amounts involved when feasible);
- Timeline that details all actions taken to resolve the issues and result of each action;
- Documentation of all meetings, which will include the names and titles of all participants and a summary of the discussion; and
- All correspondence between DCAA, the contractor, principal cognizant ACO, and the CAC, if applicable.

#### **4-804 Unsatisfactory Conditions (Mismanagement, Negligence, etc.) Related to Actions of Government Officials \*\***

##### **4-804.1 Introduction \*\***

Unsatisfactory conditions include actions by Government officials that appear to reflect mismanagement, a failure to comply with specific regulatory requirements or gross negligence in fulfilling his or her responsibility that result in substantial harm to the Government or taxpayers, or that frustrate public policy. Most unsatisfactory conditions should be handled by the region/FAO elevating the issues through the Government official's management chain. However, for some unsatisfactory conditions an independent assessment is necessary due to the sensitivity or significance of the matter. DCAA will report such conditions to the Department of Defense Inspector General (DoDIG) for appropriate action.

##### **4-804.2 Audit Responsibilities \*\***

a. Auditors should discuss unsatisfactory conditions they encountered with the FAO management and the FAO manager should assess the issues and take the appropriate actions. The FAO manager may be able to resolve some unsatisfactory conditions at the local level. For example, the FAO manager may resolve an issue related to the contracting officer by elevating it to the head of the local procurement

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office. For unsatisfactory conditions addressed at the FAO level, the FAO manager should take the necessary actions and prepare a memorandum for record (MFR) documenting the relevant facts, including judgments and conclusions supporting the actions taken. A copy should be furnished to the originating auditor for filing in the appropriate FAO file, with an information copy furnished to the RAM.

b. If the FAO's efforts to resolve the issue are unsuccessful or it is determined that the unsatisfactory conditions should not be handled at the FAO level due to the sensitivity or significance of the matter, the FAO manager should discuss the unsatisfactory conditions with the regional office. Based on these discussions, the region/FAO will determine whether to (1) attempt to resolve the issues at the regional level by elevating the issues through the Government official's management chain, or (2) forward the unsatisfactory conditions to Headquarters for forwarding to the DoDIG for resolution. If the region/FAO determine that the region should attempt to resolve the issue and those regional efforts fail, the issue will be forwarded to Headquarters.

c. Any unsatisfactory conditions forwarded to Headquarters, either for resolution at the Headquarters level or forwarding directly to the DoDIG, will be accompanied by a report prepared by the FAO describing the condition. Before the region submits the report to Headquarters, ATTN: Policy and Plans it is important that the information forwarded to Headquarters is complete and has been reviewed by the Regional Director. Incomplete submissions will be returned to the Region for additional action and result in delaying the resolution of the condition. The following are examples of items to include in the submission to Headquarters; however, it is not an all-inclusive list:

- Audit Reports and/or other documents related to the disagreement (to include monetary amounts involved when feasible);
- Timeline that details all actions taken to resolve the issues and result of each action;
- Documentation of all meetings, which will include the names and titles of all participants and a summary of the discussion; and
- All correspondence between DCAA and the Government official's management chain.

Headquarters will either attempt to resolve the issue at the Government official headquarters level or, if an independent assessment is needed, forward the submission to the DoDIG for appropriate action.

d. This special reporting to the DoDIG applies only to the most significant and sensitive issues. Less significant/sensitive matters should be handled at the local level, elevating the issue to the next higher level of management authority within the Government official's chain of command for appropriate resolution. Examples of the types of unsatisfactory conditions that may warrant an independent assessment by the

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DoDIG include, but are not limited to, the following:

(1) A contracting officer purposely excludes DCAA from performing or completing an audit to avoid a negative report (e.g., audit report with an adverse opinion).

(2) A contracting officer takes an action grossly inconsistent with procurement law and regulation; e.g., awards a contractor unreasonable or excessive costs and/or profit.

e. Contracting officers have wide authority to make decisions regarding contract matters. DCAA auditors act as advisors to contracting officers. Simple disagreement between the audit position and the contracting officer's decision is not reportable as an unsatisfactory condition.

f. Suspected irregular conduct, e.g., violations of criminal and penal statutory provisions, such as those implemented by the Joint Ethics Regulation, should be reported on the [DCAAF 2000](#) and not as unsatisfactory conditions.

### **4-900 Section 9 - Requesting Audit Guidance Regional Offices and Headquarters \*\***

#### **4-901 Introduction \*\***

a. This section states policies and procedures for processing requests to regional offices and Headquarters for expert advice, assistance, and guidance on significant auditing and accounting issues. Requirements for feedback to Headquarters on the application of guidance received are also included.

b. The policies and procedures in this section generally do not apply to requests for informal guidance. Informal guidance represents quick comments on an issue without a detailed analysis performed by the regional/Headquarters staff and with no or little management review of the guidance.

#### **4-902 Obtaining Guidance \*\***

##### **4-902.1 Definition \*\***

For purposes of this paragraph, auditing and accounting issues mean any questions involving interpretation of the FAR and DFARS cost principles, Cost Accounting Standards (CAS), Generally Accepted Government Auditing Standards (GAGAS), Generally Accepted Accounting Principles (GAAP), or other applicable laws and regulations relating to the conduct of audits or allowability, allocability, or reasonableness of costs charged to Government contracts.

##### **4-902.2 Background and General Responsibilities \*\***

a. On occasion, field auditors require assistance and advice to help resolve new, unique, complex, or controversial auditing and accounting issues. Before issues are

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elevated to the region for assistance, the FAO will research the issue by reviewing relevant guidance in CAM, open MRDs, and regulations (e.g., FAR and CAS). FAOs should not research and analyze court cases or regulatory history. When the FAO's research does not adequately resolve the issue, a request for assistance should be submitted to the regional office. The region should thoroughly research the issue using the regional library (except for requests meeting the criteria for the streamlined approach (see 4-902.2.c)).

b. When the region's research does not adequately resolve the issue, the region should submit an audit guidance request with supporting documentation to Headquarters, DCAA, ATTN: P, using the following format:

(1) SUBJECT. Always start the subject line with the following: "Request for Headquarters Guidance on ..."

(2) Program Area. Identify the major operational area; for example, FAR Cost Principles, CAS, Forward Pricing, Defective Pricing, Comprehensive Labor, etc.

(3) Problem/Issue Identification. Provide:

(a) background information regarding what generated the request;

(b) a clear and succinct statement of the problem/issue, with sufficient information to clearly explain the issue, as well as all relevant facts related to the specific circumstances; and

(c) specific questions that the region would like addressed in the guidance.

(4) Regional Staff Evaluation. Explain the nature and extent of, and the sources used in, the regional evaluation prior to submission to Headquarters. (Exclude this section when the streamlined approach is used.)

(5) Regional Alternatives. List and explain any alternatives that the regional office may have identified for resolving the issue, including the pro(s)/con(s) of each alternative. (Exclude this section when the streamlined approach is used.)

(6) Regional Recommendation. Identify the solution recommended by the region with the supporting rationale. (Exclude this section when the streamlined approach is used.)

(7) Use of Guidance. Explain how the guidance will be used; e.g., in draft audit report on [*subject*]; to rebut contractor's response to draft audit report on [*subject*].

(8) Regional Contact. Identify the regional focal point, telephone number, e-mail, and FAX number.

(9) Regional Working Paper File. Provide with the request the region's electronic assignment file containing working papers and other documents used during

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its research (as well as any relevant hard copy documents that are not available electronically). This will eliminate the need for Headquarters to duplicate research already performed by the region and should reduce the time and effort required by Headquarters to respond. Applicable working papers and other documents should be referenced in the other sections of the region's request. When the streamlined approach is used (see 4-902.2.c) relevant background documents and other documentation needed to clearly understand the facts should be submitted with and referenced in the request.

### c. Streamlined Approach.

(1) For certain types of issues, the region may not be required to perform research prior to submitting its audit guidance request to Headquarters; e.g., where a legal opinion is required; there is an urgent need for Headquarters guidance; there is no current policy covering the issue; or where external agency coordination is required.

(2) Issues that the region believes may be appropriate for the streamlined approach should be discussed with the appropriate Headquarters division as soon as the region has sufficient facts to adequately understand the issue.

(3) If it is determined that the streamlined approach is appropriate, the region should submit a request as outlined in 4-902.2.b, except that only items (1) through (3) and items (7) through (9) need to be included.

d. Headquarters will research Federal laws and regulations, FAR, DFARS, and CAS case history files, decisions of courts and boards of contract appeals, authoritative accounting literature, etc. to develop guidance. When appropriate, legal and/or technical input from outside experts or specialists will be obtained.

e. The proposed guidance will be coordinated with elements of the Office of the Secretary of Defense (OSD), when appropriate.

f. The feedback required by 4-902.4 below will be used to evaluate whether further guidance is needed.

### **4-902.3 Requesting Guidance For Use Of Legal Citations \*\***

Audit guidance is based on generally accepted accounting principles, applicable Government regulations, and rulings of Boards of Contract Appeals and Federal courts. Often the authoritative source of the guidance (e.g., a board or court case) is cited in CAM and/or specific audit guidance provided by Headquarters in support of the recommended audit conclusion. The guidance stated in CAM and specific audit guidance, including relevant legal citations, should be employed in the audit and explained in the audit report to the extent necessary to support the audit conclusions. When the auditor believes it is necessary to include in the audit report a legal citation not discussed in CAM or Headquarters guidance, the use of the citation must be formally coordinated, through the region, with Headquarters, Policy and Plans Directorate. The Headquarters division responsible for the audit issue will coordinate



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with our legal advisors and the FAO to ensure that the citation is relevant and properly applied.

### **4-902.4 Requirements for Feedback to Headquarters \*\***

a. When a guidance memorandum is issued to one region, applicable to a specific issue at a particular FAO, the region should advise the Headquarters division that issued the guidance, of the application of the guidance by forwarding to the appropriate Headquarters division copies of audit reports, memorandums to contracting officers or others, or letters to contractors or others which reflect application of the Headquarters guidance. When a region issues a guidance memorandum to an FAO without Headquarters guidance, the FAO should submit the information listed above to the regional office.

b. Regional offices will also forward to the appropriate Headquarters division copies of any resulting contractor rebuttals, contracting officer comments, related legal opinions, or other comments received that:

(1) could have an impact on the guidance previously provided; or

(2) could lead to the issuance of a general memorandum to all regions and FAOs concerning the issues and related audit guidance.

## **4-1000 Section 10 - Relying Upon the Work of Others \*\***

### **4-1001 Introduction \*\***

This section provides guidance for relying upon the work of others, except for Government technical specialists. For guidance on relying upon the work of Government technical specialists, see Appendix B.

### **4-1002 General \*\***

a. An auditor's work includes the examination or development of sufficient, appropriate, and relevant evidence to afford a reasonable basis for his/her conclusions and recommendations. In examining or developing evidence, auditors may rely upon the work of others to the extent feasible once they satisfy themselves of the quality of the other's work by appropriate tests or by other acceptable methods. Work performed by another DCAA auditor is to be presumed of sufficient quality based on DCAA's managerial controls.

b. Documentation of work performed and evidence acquired or examined is maintained or referenced in the form of working papers. Working papers are the link between field work and the audit report. They should be complete and accurate; provide support for findings, judgments, and conclusions; and demonstrate the nature and scope of the work performed (see CAM 2-302.3 and 4-400).

### **4-1003 Work Performed by Others \*\***

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a. An important source of evidence is work performed by other DCAA or Government auditors, contract administration office staff, independent public accountants, contractor internal auditors and nonauditors. It is important to maintain effective communications with these groups, to understand their responsibilities, and to know when it is appropriate to request their assistance or rely upon their work. Coordinating with these groups can often provide additional audit evidence and avoid the duplication of effort. Following is a partial list of other sources of reliance:

(1) Labor audits, floor checks, operations/IT/financial control audits, systems surveys, etc., performed by regional or other special DCAA audit teams.

(2) Assist audits performed by other DCAA audit offices on subcontracts, offsite labor, etc., or on costs which are allocated from, or records which are maintained at, home offices, other divisions, segments, cost centers, etc.

(3) Reviews performed by contract administration office staff on special cost-related subjects, procurement and inventory systems, etc.

(4) Contractor internal audits and other self-governance functions (see 4-202 and 4-302.1b.(5)).

(5) Reviews performed by the Government Accountability Office or the Inspector General.

(6) Reviews performed by independent public accountants (e.g., internal control audits conducted in conjunction with financial statement audits; see 4-302.1b.(5)).

b. The results of audits performed by foreign auditors under reciprocal agreements should not be incorporated into DCAA audit reports (see 4-1007).

### **4-1004 Deciding Whether to Rely on the Work of Others \*\***

#### **4-1004.1 General Evaluation Criteria \*\***

a. Relying on the work of others reduces the amount of work necessary to accomplish audit objectives. The evaluation of the others' work is dependent on the exercise of sound professional judgment. The work of others has to be adequate to provide reasonable assurance that the DCAA audit objectives were accomplished. Care should be taken not to dismiss the work of others for some noncritical deficiency. In deciding whether to rely on the work of others, the DCAA auditor must first evaluate the competence, independence, and objectivity of the external and internal auditors, and the nonauditor. The DCAA auditor must then evaluate the individual work product for sufficiency. The DCAA auditor should also provide feedback to the contractor/external auditors on the results of our evaluations and the extent of our reliance.

b. Under self-governance programs, contractor personnel who qualify neither as auditors nor experts may be performing oversight functions in a given area. Such

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activities are part of the contractor's system of internal controls which should be assessed in planning the audit scope.

### **4-1004.2 Evaluation of Competency, Independence, and Objectivity \*\***

a. An initial assessment must be made of the professional competence, independence, and objectivity of the external and internal auditors and nonauditors. The results of this evaluation and documentation will be included in the permanent file, and should be updated as conditions change.

b. In order to eliminate duplicate inquiries, Headquarters will monitor the following national accounting firms regarding their professional reputations, qualifications, and independence:

- (1) BDO Seidman LLP;
- (2) Deloitte & Touche LLP;
- (3) Ernst & Young LLP;
- (4) Grant Thornton LLP;
- (5) KPMG LLP;
- (6) McGladrey & Pullen LLP; and
- (7) PricewaterhouseCoopers, LLP.

This is not an exclusive list of public accounting firms that meet the Government Auditing Standard's criteria of professional reputation, qualifications, and independence. Rather it is an alphabetical listing of firms likely to be engaged by major DoD contractors. Regions and Field Audit Offices will be notified by Headquarters if problems with any of these firms are encountered. This Headquarters assessment does not alleviate the requirement for the DCAA auditor to evaluate the external auditor's work product and document that evaluation as discussed in 4-1004 and 4-1005. If reliance is to be placed on the external auditor's work, access is needed to the external auditor's working papers to perform the evaluation and documentation procedures. For other external auditors, determine that they possess the necessary competence and independence by obtaining a representation from the firm that they are:

- (a) members of the AICPA and/or state society in good standing and
- (b) that the firm is independent under the requirements of the AICPA.

c. When an entity's internal audit department has adopted the standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, the entity's internal auditors are likely to possess the requisite independence, competence and objectivity. The Standards include specific criteria for assessing independence,

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competence, and objectivity. A summary of the standards follows:

- Independence - Internal auditors should be independent of the activities they audit.
- Professional Proficiency - Internal audits should be performed with proficiency and due care.
- Scope of Work - The scope of the internal audit should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal controls and the quality of performance in carrying out assigned responsibilities.
- Performance of Audit Work - Audit work should include planning the audit, examining and evaluating information, communicating results, and following up.
- Management of the Internal Auditing Department - The Director of Internal Auditing should properly manage the internal auditing department.

Whether or not the entity's internal auditors have adopted these standards, the auditor should apply appropriate procedures to document that the internal audit department is competent, independent, and objective. Evidence should be readily available for review in the internal audit department.

d. Where appropriate, the CAC should coordinate an assessment of adherence to the above standards for the corporate managed internal audit function.

e. In determining whether an entity's internal audit department is competent, independent, and objective, the auditor should consider the following guidance:

(1) When assessing the internal auditors' competence, the auditor should obtain information about such factors as the educational level and professional experience of internal auditors, professional certification and continuing education; audit policies, procedures, and checklists; and supervision and review of internal auditors' activities.

(2) When assessing the internal auditors' independence and objectivity, the auditor should obtain information about such factors as the organizational status, including whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors. In addition, review policies to maintain internal auditors' objectivity about the areas audited, including policies prohibiting internal auditors from auditing areas where they were recently assigned or are scheduled to be assigned on completion of responsibilities in the internal audit function.

f. The assessment of the internal auditor's independence, competence and objectivity should be used in determining:

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(1) whether reliance can be placed on the internal auditor's work, and

(2) if so, the extent of testing needed to evaluate the internal auditor's work product (i.e., less testing is needed if no deficiencies exist; increased testing is needed if deficiencies exist).

In any case, the contractor should be notified of any deficiencies and the impact of those deficiencies on DCAA's ability to place reliance on the internal auditor's work.

g. For nonauditors (consultants, experts, specialists, etc.), other than those assisting in the audit, the auditor should consider:

(1) the professional certification, license, or other recognition of the competence of the specialist in his field, as appropriate,

(2) the reputation and standing of the specialist in the views of his peers and others familiar with his capability or performance, and

(3) the relationship, if any, of the specialist to the client.

### **4-1004.3 Evaluation of Work Product \*\***

a. To satisfy certain of the requirements discussed in subsections b through d below, access to working papers is required. Accordingly, make arrangements to ensure that working papers will be available. Evaluation of the work product should be based on a comparison of the audit steps the DCAA auditor believes are necessary to those which were performed. If the DCAA auditor concludes that audit program steps essential to developing evidence to support an unqualified opinion have not been performed, those additional steps must be performed by the auditor before issuing an audit report.

b. When evaluating the work of external auditors, consider whether to conduct additional tests and procedures, such as reviewing the audit procedures they followed and the results of audits they conducted (including their assessment of control risk). The auditor should review their audit programs and/or working papers, tests of compliance, and conclusions reached. The auditor may review the documentary evidence in the external auditors' working papers or make supplemental tests of the work conducted.

c. In evaluating the work of internal auditors, the DCAA auditor should examine, on a test basis, documentary evidence of the work performed by the internal auditors. He or she should consider such factors as whether the scope of the work is appropriate, audit programs are adequate, working papers adequately document work performed, conclusions reached are appropriate in the circumstances, and any reports prepared are consistent with the results of the work performed. The DCAA auditor should also perform tests of some of the work of internal auditors. The extent of these tests will vary depending on the circumstances, including the type of transactions, their materiality, results of prior audits; and the independence, objectivity, and competence of the internal

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audit organization as discussed in 4-1004.2 above. These tests may be accomplished by either:

(1) examining some of the transactions or balances that internal auditors examined or

(2) examining similar transactions or balances but not those actually examined by internal auditors.

The DCAA auditor should compare the results of his tests with the results of the internal auditors' work in reaching conclusions as to whether DCAA can place reliance on their work.

d. In evaluating the work of nonauditors, consider whether to:

(1) conduct additional tests and procedures (e.g., reviewing the procedures followed and the results of the work conducted),

(2) review the work program,

(3) review the working papers,

(4) make supplemental tests of the work conducted, and

(5) consider the methods or assumptions used.

### **4-1005 Documentation Requirements \*\***

a. Whenever reliance is placed upon the work of others, documentation is required. Reliance must be based upon specific knowledge of the actual work performed and the results obtained. It is not to be based merely upon the assumption or general knowledge that work is to be performed by others.

b. The extent of documentation needed is a matter of auditor judgment. However, there should be sufficient documentation to describe the scope of work performed, the period and costs/audit area covered, the nature and extent of audit procedures applied, the evidence obtained and analyzed, and the audit results. The documentation may include copies of working papers, audit programs, reports, third party confirmations, and DCAA auditor prepared summaries of the work performed. The documentation should also describe the extent of reliance that will be placed upon the work of others.

c. In rendering an audit opinion, consider all work performed, including that performed by others. If work of others is not sufficient in scope and as a result an unqualified opinion cannot be rendered, take steps to obtain additional evidential matter. Where the scope of work performed by other government representatives does not appear to be sufficient in scope, consult with the organization involved to obtain clarification or any additional information available. If reliance still cannot be placed on the work, advise the contractor of the need for additional audit work, how it relates to the work already

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performed by the other organization, and why it will not duplicate prior Government audits. If additional evidential matter cannot be obtained, then render either a qualified or adverse opinion. See CAM 9-211.2 and CAM 9-211.3.

d. In determining the extent of documentation to be included in the working paper file, the auditor should apply the guidance contained in 4-406. To the extent possible, document reliance on the work of others by reference, notes, or extractions. Where a particularly sensitive or material audit conclusion hinges on other auditors' working papers and referencing/extraction would not be practical, include appropriate copies in DCAA working papers.

### **4-1006 Referencing the Work of Others in Audit Reports \*\***

#### **4-1006.1 Specialists \*\***

Refer to B-110, for guidance on referencing the specialists work in the audit report. See CAM 10-208.5a(2) and CAM 10-304.10 for suggested audit report comments when incorporating the results of technical review.

#### **4-1006.2 Part of an Audit Performed by Other Auditors \*\***

a. The DCAA mission includes providing all contract auditing for the DoD, and providing accounting and financial advisory services to all DoD procurement and contract administration activities (see CAM 1-102). Because DCAA has the ultimate responsibility to express an opinion on contract audit issues, judgments about assessments of inherent and control risk, materiality, sufficiency of tests, and other matters affecting the opinion must be judgments of the DCAA auditor. Recognition of the contractor's participation in self-governance should be included in the DCAA audit report in a manner which does not imply a limitation of scope or a qualification of opinion.

b. Ordinarily you need not make reference to work performed by another auditor if:

(1) the other auditor works for an organization associated with your organization (e.g., another DCAA office (see 4-1002a)) and whose work is acceptable to you based on your knowledge of the professional standards and competence of that organization; or

(2) the other auditor is retained by DCAA and the work is performed under DCAA guidance and control; or

(3) you take steps necessary to satisfy yourself with the other auditor's work; or

(4) the work performed by the other auditor is not material to the opinion being expressed.

c. Once field work is complete, a report using the applicable format in CAM

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Chapter 10 will be used. In addition, if another auditor's work provides relevant information to promote adequate understanding of matters being reported, the report may include:

(1) In the "Results of Audit" section, in additional comments:

- information on another auditor's work, including a brief statement on the purpose, scope, and a summary of results;
- a statement indicating if the other auditor's report has been provided to the PCO/ACO or is attached to the report;
- expression of appreciation for the participation of non-DCAA personnel in the audit effort (see CAM 10- 208.5d(2)).

(2) A reference in the explanatory notes accompanying the report exhibits, schedules, and appendixes to the other auditor's scope and findings as they relate to the DCAA reported conclusions. Based upon the complexity and/or the nature of the findings, it may be appropriate to include the other auditor's report as an appendix. However, this should not be done without first obtaining authorization from the other auditor.

### **4-1007 Audits Performed by Foreign Auditors Under Reciprocal Agreements \*\***

a. The United States Department of Defense (DoD) has agreements with the Governments of certain foreign countries to provide contract audit services and other contract administration services without charge. Under these agreements, DCAA performs audits of U.S. companies performing or bidding on contracts of the foreign country. In return, the auditors of the foreign country perform audits of the foreign companies performing or bidding on U.S. Government contracts. The U.S. currently has reciprocal audit agreements with five countries; Canada, United Kingdom, France, Netherlands, and Germany. Audits of foreign companies in countries not covered by reciprocal audit agreements will be performed by the appropriate FAO (e.g. Pacific Branch Office, European Branch Office).

b. When audits are performed by foreign auditors under reciprocal agreements, performing the procedures required by auditing standards to allow incorporation of the foreign auditors' results into DCAA audit reports is generally not possible because access needed to perform the procedures is generally precluded by terms of the agreements and restrictions on disclosing proprietary information to the purchasing government. Therefore, the results of audits performed by foreign auditors are not to be incorporated into DCAA audit reports.

c. When requested to audit a contractor submission (e.g., incurred cost or forward pricing proposal) that includes costs requiring audit by foreign auditors under a reciprocal agreement, the FAO should coordinate with the contracting officer. The FAO should advise the contracting officer that DCAA is unable to perform the procedures



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required by auditing standards to allow incorporation of the foreign auditors' results into the DCAA audit report and that the report opinion will not address those portions of the contractor's submission that are subject to coverage by the foreign auditors. The FAO should recommend that the contracting officer use the procedures outlined in the applicable reciprocal agreement to request that a separate audit of the foreign company's costs be performed by the foreign auditors and that the foreign auditor's report be sent directly to the contracting officer.

d. For example, if DCAA were requested to audit a contractor's forward pricing proposal which includes foreign subcontract costs requiring audit by foreign auditor under a reciprocal agreement, the FAO would audit only the parts of the proposal under DCAA's cognizance using activity code 27000. (See CAM 9-104.2 for guidance on advising the contracting officer on the need for subcontract assist audits.) A similar "parts of submission" approach should be used for incurred cost audits that include foreign subcontract costs. In such cases, the standard subject of audit paragraph should be modified to indicate that the FAO examined the contractor's proposal and related books and records, except for the foreign subcontract costs and provide information sufficient to clearly identify the costs not audited.

e. In situations where the costs audited by the foreign auditors cannot be readily separated and therefore a "parts of submission" approach cannot be used (e.g., audits of incurred cost submissions including indirect flow-down costs from a foreign company), the audit report will clearly identify those costs that the FAO did not audit and will be appropriately qualified.

f. In the event the FAO receives the audit report from the foreign auditors, it should be immediately forwarded to contracting officer. The foreign country's audit report should not be incorporated into the DCAA audit report.