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United States  
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### **Acronyms**

AICPA	American Institute of Certified Public Accountants
AUP	Agreed-Upon Procedures
CACS	Contract Audit Closing Statement
CAM	Contract Audit Manual
CAS	Cost Accounting Standards
DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulations
GAS	Government Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
ICSR	Internal Control System Review
ODC	Other Direct Costs
PCIE	President's Council on Integrity and Efficiency



INSPECTOR GENERAL  
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MAY - 1 2007

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Review of the Defense Contract Audit Agency Quality Control System  
(Report No. D-2007-6-006)

We have reviewed the Defense Contract Audit Agency (DCAA) system of quality control for the fiscal year ended September 30, 2006. In our opinion, the DCAA system of quality control for audits and attestation engagements performed during the FY ended September 30, 2006, was designed in accordance with quality standards established by Government Auditing Standards (GAS). Further, the internal quality control system was operating effectively to provide reasonable assurance that DCAA personnel were following established policies, procedures, and applicable auditing standards. Accordingly, we have determined that the DCAA system of quality control used on audits and attestation engagements for the review period ended September 30, 2006, is adequate.

The GAS require that an audit organization performing audits or attestation engagements, or both, in accordance with GAS have an appropriate internal quality control system in place and undergo an external quality control review at least once every 3 years by reviewers independent of the audit organization being reviewed. An audit organization's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance that they meet the objectives of quality control. We tested the DCAA system of quality control to the extent we considered appropriate.

Appendix A contains comments, observations, and recommendations where DCAA can improve its quality control program related to auditing and attestation engagement practices. Appendix B contains the scope and methodology of the review.

The DCAA management comments to the draft report are included in their entirety as Appendix D. We agree with the DCAA proposed corrective action for recommendations 1, 2, 3, 4, 5(a and b), 6(a, c, and d), 9(a, b, and d) and 10(a and b). However, we request DCAA reconsider their position on recommendations 6(b), 7, 8(a, b, and c) and 9(c) in the final response due June 1, 2007.

We wish to express our thanks to you and your staff for your cooperation and professionalism. Please contact Ms. Diane Stetler at (703) 604-8737 if you have any questions. See Appendix C for the report distribution.

Handwritten signature of Wayne C. Berry in black ink.

Wayne C. Berry  
Acting Assistant Inspector General  
for Audit Policy and Oversight

\* An opinion that the system is adequate and functioning as prescribed is equal to an unmodified opinion as defined by the President's Council on Integrity and Efficiency.

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# Appendix A. Comments, Observations, and Recommendations

We determined that the DCAA quality control system is adequately designed and functioning as prescribed.<sup>1</sup> The concerns we identified with the findings, conclusions, or recommendations during our review of the selected DCAA assignments and associated reports were not cumulatively significant enough to indicate that material deficiencies existed in the DCAA quality control system for complying with generally accepted government auditing standards (GAGAS). Also, DCAA demonstrated that it implemented internal procedures for monitoring its ongoing compliance with quality control policies and procedures. Specifically, DCAA performed cyclical internal quality assurance reviews during the prior 3 years on forward pricing, internal control system, incurred cost, and “All Other<sup>2</sup>” reviews and the general standards.

Although the concerns we identified did not affect our overall opinion, DCAA could improve its quality assurance program by assigning independent quality assurance auditors to review Field Detachment assignments, increasing coverage of internal control system reviews (ICSRs), and verifying audit office implementation of repeat noncompliances. DCAA should also revise its guidance for attestation engagements on desk reviews of incurred cost submissions under \$15 million; contract audit closing statement reviews; Agreed-Upon Procedures (AUPs) engagements; identification of criteria; planning, risk assessment, and designing tests for fraud, illegal acts, violations of contracts or grant agreements, and abuse; and documentation and reporting of sampling plans. Implementing the following recommendations would improve the quality control system and help maintain an adequate opinion.

## Quality Control and Assurance

**1. Independent Internal Quality Assurance Review of Field Detachment Offices.** From June 2005 through October 2006, the DCAA process for allowing auditors<sup>3</sup> from the Field Detachment quality assurance division to perform the overall headquarters-led quality assurance reviews of selected Field Detachment offices did not provide the needed independence for an internal quality assurance review. Originally, DCAA decided not to independently test the Field Detachment based on workload, security considerations, and the fact that DCAA considers the Field Detachment Quality Assurance Division independent because it is separate from Field Detachment audit operations. During the DCAA first cycle of quality assurance reviews, as an alternative to our recommendation to have independent reviewers perform the Field Detachment internal quality assurance review, DCAA added the requirement for the Deputy Director, DCAA, to select the offices for review and review the draft and review and sign the final memorandums for record. However, during the second cycle of quality assurance reviews, the Deputy Director retired and in June 2005, the Director, Field Detachment,

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<sup>1</sup> An adequate system that is functioning as prescribed equals an unmodified opinion as defined by the President’s Council on Integrity and Efficiency.

<sup>2</sup> “All Other” reviews include Cost Accounting Standards and Disclosure Statement reviews, equitable adjustments, terminations, defective pricing, and special reviews.

<sup>3</sup> The terms “audit” and “auditor” are used generically by both DCAA and the Government Accountability Office to cover all types of evaluations done in accordance with GAGAS or individuals with titles other than “auditor” who perform such reviews.

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assumed the Deputy Director position. DCAA recognized that an independence issue existed because the new Deputy Director had had overall management responsibility for the Field Detachment. To resolve the independence issue, DCAA requested the required security clearance for a headquarters quality assurance staff member. In December 2006, DCAA informed us that the clearance had been granted.

One independent reviewer on the headquarters-led internal quality assurance team is the minimum needed. Headquarters-led internal quality assurance reviews of audit offices in the five regions are performed entirely by quality assurance staff from either headquarters or other regions. DCAA should revise the review process for Field Detachment so that it more closely follows the same process for the regions, taking into account security considerations. This would require the Chief, Quality Assurance Division, Policy and Plans, to obtain the required clearances so that they can review and properly oversee the work. Other quality assurance staff would also require clearances or access to unclassified Field Detachment work.

During our review of the Field Detachment location, we found that all assignments performed by the office were not classified; therefore, an uncleared headquarters quality assurance team member could review some assignments at certain Field Detachment offices depending on security requirements such as facility access. In the past, the DCAA Field Detachment has placed uncleared auditors in unclassified areas at locations with classified work and provided them with unclassified assignments to perform while awaiting their security clearances. However, when allowing an uncleared quality assurance auditor access to unclassified assignments is too great a security risk, DCAA headquarters should ensure that more than one headquarters or regional quality assurance auditor has the necessary clearances. Obtaining the required clearances can take more than a year depending on the circumstances, and relying on one quality assurance auditor to work on all the reviews may not be practical. That individual may be promoted or rotated to a different position within several years, require an extended leave of absence, or encounter a personal independence issue that could require them to recuse themselves from a review. Therefore, DCAA headquarters should take additional steps so that more than one independent quality assurance auditor can be assigned to each headquarters-led quality assurance review of Field Detachment assignments.

## **Recommendations, Management Comments, and DoD IG Response**

**1. The Director, Defense Contract Audit Agency should revise the headquarters-led quality assurance review process and obtain the needed security clearances and billets so that:**

**(a.) the Chief, Quality Assurance Division, Policy and Plans, has the required clearance(s) for access to Field Detachment work, and**

**(b.) more than one headquarters or regional quality assurance auditors can participate in the headquarters-led internal quality assurance reviews of Field Detachment offices.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans partially concurred with the recommendations. DCAA agreed to have a second member of the Headquarters, Quality Assurance Division staff obtain the necessary security clearance but disagrees with the recommendation that the Chief, Quality Assurance Division, should obtain a security clearance for access to Field Detachment audit work.

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**DoD IG Response.** We accept the DCAA proposed action as partially meeting the intent of the recommendations. However, DCAA should reconsider its nonconcurrency to getting the Chief of the Quality Assurance Division the necessary clearances to properly supervise the quality reviews of the Field Detachment. Proper supervision requires the supervisor have access to the same data the auditor saw.

## **2. Quality Assurance Program Coverage of Internal Control System**

**Reviews.** DCAA reduced its coverage of ICSRs to an inappropriate level during its second cycle of headquarters-led quality assurance reviews by selecting significantly fewer offices and assignments for review. During the first cycle, DCAA reviewed a total of 84 ICSRs at 18 audit offices. For the second cycle, DCAA reviewed 36 ICSRs at 6 offices and 10 estimating system reviews at 10 additional audit offices for a total of 46 ICSRs. The first cycle coverage was based on the number of ICSR assignments performed. For the second cycle, DCAA based the number of ICSRs reviewed on the direct audit hours charged to system reviews, not including estimating, as a percentage of total direct hours charged. DCAA auditors charged 8.5 percent of the total direct hours to ICSR assignments in FY 2003 versus 5.6 percent of total direct audit hours in FY 1999.<sup>4</sup> Even though the percent of direct hours charged to ICSRs increased, the second cycle quality assurance reviews covered only half the number of assignments reviewed during the first cycle. Other than for estimating system reviews, the quality assurance review process did not cover enough audit offices to provide assurance that a deficiency did not exist across the agency unless the deficiency was so severe that it occurred at almost all offices. Additionally, the second cycle review did not include a sufficient number of certain ICSRs to followup on previously identified deficiencies. For instance, in the first cycle, DCAA found that during the Indirect Cost and ODC [Other Direct Costs] System reviews the offices were not always adequately auditing the portion of the system relating to ODCs. DCAA determined that the standard program needed to be revised. During the second cycle, the quality assurance review team only evaluated one Indirect Cost and ODC System review for compliance with GAGAS. One review is not sufficient to determine whether prior corrective actions have been effective.

DCAA uses the ICSRs results as a major part of their risk assessment for all other work performed at a major contractor. DCAA identifies 10 internal control systems that may be appropriate to review at each major<sup>5</sup> contractor. In FY 2006, DCAA expended only 6.4 percent of direct audit hours on performing ICSRs. However, during the same time period, DCAA used the results from ICSRs to assess risk when auditing \$247 billion or 72 percent of total FY 2006 dollars examined, on assignments for major contractors. During the FY 2006 external quality control system review, we identified 5 of 24 ICSRs (20 percent) reviewed where DCAA inappropriately opined on the adequacy of a contractor's internal control system because of insufficient compliance testing or other evidence issues. Sufficient compliance testing during the ICSRs is essential for ensuring that the appropriate amount of testing or review is performed on other assignments at the same contractor. Therefore, DCAA should increase the number of audit offices and assignments reviewed during its quality assurance reviews of ICSRs and perform other monitoring activities of ICSRs because inadequate ICSRs have a far-reaching effect on other DCAA work. A reasonable approach, considering resource restraints, would be for DCAA to double the number of offices reviewed during the second cycle while maintaining the number of assignments reviewed at six per office. This approach should broaden the overall coverage, but not increase the time spent reviewing each office.

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<sup>4</sup> DCAA auditors charged more hours in FY 2003 (300,100) versus FY 1999 (264,401) to ICSRs.

<sup>5</sup> A major contractor is one with \$90 million or more in auditable contract dollars.

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## **Recommendation, Management Comments, and DoD IG Response**

### **Recommendation 2.**

**The Director, Defense Contract Audit Agency should provide the headquarters Quality Assurance Division with additional staff so that at least 12 audit offices and 72 internal control system reviews can be reviewed during the third quality control cycle of internal control system reviews.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans partially concurred with the recommendation. DCAA agreed that for the current round of the Headquarters Quality Assurance Division reviews, they would expand their review of ICSR assignments by increasing the number of FAOs and assignments reviewed based on number of ICSR assignments performed by region and related to risk.

**DoD IG Response.** We accept the DCAA proposed actions as satisfying the intent of the recommendation.

**3. Quality Assurance Program Followup on Repeat Noncompliances at Audit Offices.** For its second cycle of headquarters-led internal quality control reviews, DCAA identified repeat noncompliances at 22 of 48 reviewed audit offices. DCAA considered agency-wide repeat noncompliances to be implementation issues, and, therefore, headquarters quality assurance division was not involved in determining whether the audit office had implemented effective corrective actions for the repeat noncompliances. For 17 audit offices that DCAA rated “satisfactory” out of the 22 that had repeat noncompliances, neither headquarters nor the region was required to perform any follow-up on the planned corrective actions. The headquarters Quality Assurance Division did review the audit offices’ comments to the trip reports and the proposed corrective actions to ensure that the audit office planned to take additional actions beyond those previously taken. Continued repeat noncompliances may indicate significant deficiencies in the DCAA quality control system, and could negatively impact the overall opinion. Therefore either the regional or headquarters quality assurance team should verify that the audit offices properly implemented the planned corrective action and that it was effective.

## **Recommendation, Management Comments, and DoD IG Response**

### **Recommendation 3.**

**The Director, Defense Contract Audit Agency should revise the existing headquarters-led quality assurance review process starting with followup actions for the second round so that either a regional or headquarters quality assurance staff member would evaluate the effectiveness of corrective actions planned or implemented by each audit office for all repeat noncompliances.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans partially concurred with the recommendation. DCAA agreed to revise the Headquarters Quality Assurance process to require Regional Quality Assurance staff to evaluate the effectiveness of the corrective actions implemented by audit offices for repeat noncompliances. DCAA plans to begin the new process for the third round of quality assurance reviews, which began in October 2006. However, DCAA will not apply the process to the corrective actions proposed for the second round of quality assurance reviews.

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**DoD IG Response.** Although the DCAA proposed action meets the intent of the recommendation, we suggest DCAA reconsider their decision not to implement the process on the corrective actions proposed in the second round. Early identification of ineffective corrective actions would allow time for reassessment and implementation of alternative actions.

## **Types of Attestation Engagements**

**4. Desk Reviews of Contractor Incurred Cost Submissions Under \$15 Million.** DCAA did not comply with GAGAS when performing incurred cost desk reviews as review-level engagements. The purpose of an incurred cost assignment is to determine whether the contractor complied with applicable laws, regulations, and contract provisions when charging costs to the Government. GAGAS, however, does not permit auditors to perform a review-level engagement when determining whether an entity has complied with laws and regulations.

DCAA must either perform the desk reviews as an examination or AUP engagement or not state that a desk review was performed in accordance with GAGAS. DCAA performs desk reviews on incurred cost submissions from contractors that have less than \$15 million in auditable dollars and are considered low risk because DCAA did not identify questioned costs on previous incurred cost assignments. For these contractors, DCAA performs an examination of their incurred cost submission only once every 3 years. For the other 2 years, DCAA performs a limited review, issues a report providing negative assurance, and states the review was performed in accordance with GAGAS. In FY 2006, DCAA auditors charged more than 33,500 hours to desk reviews and recorded \$1.6 billion as dollars examined. DCAA should correct the noncompliance in a timely manner by either issuing guidance that conforms with GAGAS to the field on how to perform or report on desk reviews or temporarily suspend performance of desk reviews until the GAGAS noncompliance issue is resolved.

## **Recommendation, Management Comments, and DoD IG Response**

### **Recommendation 4.**

**The Director, Defense Contract Audit Agency should suspend the performance of desk reviews until agency guidance on performing desk reviews is issued that complies with generally accepted government auditing standards.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans concurred in principle with the recommendation. DCAA issued guidance on April 11, 2007, effective immediately, requiring desk reviews be closed by issuing a memorandum that does not state the review was performed in accordance with GAGAS.

**DoD IG Response.** We accept the DCAA actions as satisfying the intent of the recommendation and commend DCAA on taking immediate corrective actions.

**5. Contract Audit Closing Statement Assignments.** DCAA did not comply with the applicable GAGAS requirements when performing the six reviewed contract audit closing statement (CACS) assignments<sup>6</sup> because its CACS standard programs do not prompt an auditor to perform key required audit steps. DCAA performs CACS

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<sup>6</sup> For FY 2006, DCAA auditors charged approximately 1.7 percent of direct hours to CACS.



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normally as an examination, but for situations when a quick close-out is permissible, DCAA performs an AUP. For CACS performed as an examination, the standard program clearly states that the closing procedures are administrative in nature and DCAA should have audited the costs in other assignments. Steps are included to reconcile the voucher to either the audit files or the contractors records; however, a CACS assignment is still, generally, a summary or restatement of prior audit work that should have complied with GAGAS and does not itself actually comply with GAGAS as stated in the report. For instance, the CACS standard program does not have steps to design procedures to detect or identify potential fraud that is material to the assertion. Additionally, because DCAA only issues a CACS report when cumulative allowable cost worksheets have not been prepared for the entire period of performance, apparently, contracting officers do not require an opinion as provided in an examination report to close out the contract. Under these circumstances, DCAA should revise its procedures to issue a report that specifies that the review was not performed in compliance with GAGAS. The report format should also be revised to eliminate any wording that might improperly infer to the user otherwise.

For CACS performed as AUPs, the standard program does not include a step for the auditor to discuss performing an AUP with the contracting officer. Therefore, the auditor does not have to obtain the requestor's agreement with the planned procedures to be performed or document that the requestor assumes the responsibility for the procedures and criteria. DCAA performs quick close out CACS assignments when they have not audited all the incurred costs, but the contracting officer is allowed by Federal Acquisition Regulations (FAR) to close out a contract prior to finalizing all the indirect rates. DCAA must confirm with the contracting officer that the contract is subject to quick close out and what procedures the contracting officer requires DCAA to perform. Therefore, for DCAA to perform these CACS as AUPs, they need to revise the standard program to require the auditor to perform and document these keys steps. DCAA could choose to issue a report that specifically states the review was not done in compliance with GAGAS and remove any standard wording that could confuse the user by inferring that the auditor had performed a GAGAS compliant review.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 5.**

**The Director, Defense Contract Audit Agency should:**

**(a.) determine whether contract audit closing statement reviews should be performed in compliance with generally accepted government auditing standards, and, if so, what type of attestation engagement, and**

**(b.) revise the Contract Audit Manual guidance, standard audit programs, pro forma reports, and training for performing contract audit closing statements are revised based on that decision.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans concurred with the recommendations and has initiated a study of their guidance on performing CACS assignments. DCAA intends to revise their guidance by October 2007, for the performance of CACS assignments based on the results of the study. DCAA disagreed with the conclusion that CACS assignments were not performed in compliance with GAGAS because GAGAS evidence standards provides for the reliance on the work of others.

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**DoD IG Response.** We accept the DCAA actions as responsive to the intent of the recommendations.

**6. Agreed-Upon Procedures Engagements.** In the majority of the 21 reviewed AUP engagements,<sup>7</sup> DCAA did not comply with key GAGAS or American Institute of Certified Public Accountants (AICPA) attestation standards as incorporated in GAGAS.<sup>8</sup> Noncompliances with GAGAS identified in the AUP assignments reviewed included assignments that:

- had no evidence that the requestor agreed to or accepted responsibility for the procedures performed;
- did not have the criteria appropriately defined;
- did not define the procedures appropriately; and
- did not comply with all the reporting requirements.

In three of the worst situations, the noncompliances were so significant that the related reports contained misleading, inaccurate, or incomplete information and, therefore, should not have been issued.

DCAA revised its guidance and required training based on its last two headquarters-led quality assurance reviews. However, DCAA needs to implement several additional corrective actions so that agency auditors consistently comply with the GAGAS when performing AUPs. In July 2004, to correct deficiencies identified by the DCAA headquarters-led quality assurance team in performance of AUPs during the FY 2003 quality assurance review of forward pricing audits, DCAA issued revised guidance on AUPs and required the audit offices to provide training using headquarters-developed AUP training materials. During its FY 2006 quality assurance review of “All Other” assignments, DCAA again identified deficiencies in performance of AUPs, but they considered the deficiencies less significant than those from the first cycle quality assurance reviews. DCAA required all regional and Field Detachment management to establish and submit to the Deputy Director for approval an appropriate quality control monitoring process for planning, performing, and reporting AUPs by April 28, 2006. In a November 9, 2006, memorandum, DCAA Headquarters provided training materials for Regional and Field Detachment office staff to assist them in their AUP monitoring efforts. The training was to be completed by January 31, 2007. In March 2007, DCAA has issued a required AUP self-study course that auditors must take prior to performing their first AUP assignment.

DCAA revised existing Contract Audit Manual (CAM) language and pro forma reports to make them applicable to AUPs, but this resulted in inconsistent guidance that did not fully comply with GAGAS. For instance, DCAA guidance instructs auditors to revise audit reports by deleting the word “audit” and inserting the phrase “application of agreed-upon procedures.” AUP reports should state that no opinion is provided and only present the procedures performed and the results. DCAA guidance instructs the auditor that

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<sup>7</sup> DCAA estimates that in FY 2006, auditors only charged 2 percent of direct audit hours to AUPs.

<sup>8</sup> GAGAS incorporates the AICPA general standard on criteria for attestation engagements and requires auditors to also follow all the GAGAS general standards when performing work in compliance with GAGAS. It also incorporates the AICPA field work and reporting standards for attestation engagements and, as of when DCAA performed the reviewed audit assignments, all the AICPA Standards for Attestation Engagements. Additionally, GAGAS provides additional field work and reporting standards for attestation engagements performed in compliance with GAGAS.

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when writing the results section of the report, they should describe the contractor books and records to which the agreed-upon procedures were applied and that the auditor should provide appropriate explanatory notes. However, explanatory notes generally include far more information such as the contractor's basis for a cost, than is required for AUPs. For AUPs, the auditor should separately list each agreed-upon procedure and then describe the finding for that procedure. Therefore, the edit changes did not clarify the reporting guidance and pro forma report. Instead, auditors could easily become confused about what they should do when performing AUPs. In another CAM section, the guidance discusses the GAGAS applicable to AUPs and uses poorly chosen words to conclude, "The agreed-upon procedure engagements are not considered examinations because of limitations of the audit scope." This statement infers that an auditor could start an assignment as an AUP and then, by eliminating a scope limitation, make it an examination. However, because the requestor assumes full responsibility for the adequacy of the procedures and the criteria, performing an AUP does not require the same planning steps as an examination.

DCAA should completely rewrite the guidance on AUPs to fully comply with GAGAS requirements and consolidate all guidance, not including guidance on report content, in a separate chapter or chapter section in its CAM. This would lessen the chance that auditors would confuse an AUP with other attestation engagements and facilitate auditor compliance with GAGAS for AUPs. DCAA should also revise its pro forma audit report for AUPs so that it specifically covers GAGAS required reporting elements for AUPs. The current pro forma AUP report is a revised version of its other pro forma audit reports and, therefore, does not present the required information in as straight forward a manner as is possible. This, in turn, can confuse both the auditor drafting an AUP report and the requestor who reads it.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 6.**

**The Director, Defense Contract Audit Agency should:**

- (a.) revise all guidance on performing agreed-upon procedures engagements in a separate Contract Audit Manual chapter or section of a chapter solely devoted to agreed-upon procedures engagements,**
- (b.) revise the agreed-upon procedures pro forma report so that it complies with generally accepted government auditing standards and is easily distinguished from other standard audit report formats,**
- (c.) identify and track all assignments performed as agreed-upon procedures engagements in the agency management information system, and**
- (d.) require regional and Field Detachment management to monitor on an ongoing basis agreed-upon procedures engagements to ensure that they are performed in compliance with generally accepted government auditing standards until the headquarters-led quality assurance review team completes the third cycle reviews.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans concurred with recommendation (a.) and plans to consolidate the DCAA guidance for AUPs, except

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reporting guidance, into one chapter, Chapter 14, of the Contract Audit Manual. DCAA partially concurred with recommendations (c.) and (d.). DCAA stated that the DMIS already tracks AUPS under activity codes 17900 and 28000 and plans to reassess their policy for performing AUPs under other activity codes. In addition, DCAA agreed to continue monitoring AUP engagements until DCAA management is satisfied that AUP assignments have improved compliance with GAGAS. DCAA nonconcurred with recommendation (b.) because they believe that the AUP pro forma report does comply with GAGAS.

**DoD IG Response.** We accept the DCAA planned and initiated actions as satisfying the intent of our recommendations except for recommendation (b.). We still believe that DCAA should develop an AUP pro forma report that presents GAGAS requirements simply and clearly and is noticeably different from an examination report. This will preclude auditors from confusing AUP reporting and examination reporting requirements. We request DCAA reconsider its nonoccurrence with recommendation (b.).

## Criteria

**7. Identification of Criteria.** DCAA auditors did not properly identify the specific criteria used in the working papers or in the associated report for all of the examination and review assignments<sup>9</sup> we reviewed. In 15 of the 120<sup>10</sup> reviewed examination or review assignments, the auditors did not adequately identify the criteria used in the Planning Document for the assignment. DCAA performed 9 of the 15 assignments for non-DoD agencies.<sup>11</sup> In three<sup>12</sup> of the nine assignments, the auditor referenced the Defense Federal Acquisition Regulation Supplement (DFARS) instead of the requesting agency's supplement in all the working papers and the associated reports. In the other six assignments, the auditors did not reference specific sections of the other agencies' supplements in the working papers or the report nor did they document that no differences existed between the applicable sections in DFARS and the other agency supplement. None of the reviewed assignments performed for a classified agency by the Field Detachment audit office specifically identified the relevant other agency FAR [Federal Acquisition Regulations] supplement, and the audit office could not provide us access to it. We later found that the other agency FAR supplement was unclassified and available on an internet website.

DCAA guidance does not fully comply with the GAGAS requirements to explicitly and completely state the criteria used and cite the source for the criteria in the report because it requires an auditor to list only specific criteria when documenting or reporting exceptions or findings such as questioned cost. Although CAM states that working papers should contain a detailed description of the work performed, including criteria, in the scope section, the associated examples of proper criteria documentation, particularly on the standard A-1, "Planning Document," working papers are very general, stating simply "FAR, DFARS, or Applicable Agency FAR Supplement, and CAS [cost

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<sup>9</sup> Deficiencies related to criteria in AUPs are separately covered in "Agreed-Upon Procedures Engagements," Number 6 above.

<sup>10</sup> Of the 141 assignments reviewed, 21 were AUPs; therefore, examinations and reviews accounted for the remaining 120 reviewed assignments, number 6 above.

<sup>11</sup> We reviewed a total of 16 audit assignments that DCAA performed for non-DoD agencies on a reimbursable basis.

<sup>12</sup> These 3 assignments were performed by 2 offices.

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simply “FAR, DFARS, or Applicable Agency FAR Supplement, and CAS [cost accounting standards].” For report writing, the guidance is similar to that for planning as shown in the pro forma attestation reports example. Both the FAR and DFARS are voluminous; therefore, some further definition of the specific section(s) of FAR and DFARS is needed. When the auditor uses such general criteria in the planning document, they must then include more defined criteria used related to specific tests or other steps in the relevant working papers. To comply with other GAGAS requirements, including proper supervision and internal and external quality assurance reviews of the work, the auditor must identify the specific criteria used in the working papers and the report.

Supervisors, internal quality assurance reviewers, and external reviewers should not assume that the auditor used the correct criteria. They must be able to verify the specific criteria used to assess the work performed.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 7.**

**The Director, Defense Contract Audit Agency should revise the Contract Audit Manual to require auditors to identify the specific criteria actually used in the performance of attestation examinations and reviews either on the planning document working paper or in the scope section of working papers.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans nonconcurred with the recommendation. DCAA did agree that applicable non-DoD regulations should be referenced in the report and working papers and issued policy in December 2006 to that effect. However, DCAA believes that their guidance, which requires authoritative criteria (FAR, DFARS, CAS) used in audit procedures testing for compliance be documented in the working papers and that specific provision of the criteria (FAR 31.205-33) be documented in the case of noncompliance practices or costs questioned, complies with GAGAS.

**DoD IG Response.** DCAA needs to reconsider its position on this recommendation. GAGAS requires auditors to state the criteria to provide a context for evaluating evidence and understanding the findings. Without the criteria, supervisors, internal quality assurance reviewers, and external reviewers are unable to verify the specific criteria an Auditor used to assess the work performed, even if there are no noncompliance practices or costs questioned.

## **Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, and Abuse**

**8. Planning, Risk Assessment, and Designing Tests.** The six audit offices evaluated during our review did not implement the DCAA guidance for major contractors requiring them to ask contractor representatives about their knowledge of fraud risks during the annual audit coordination process. DCAA also expected its auditors to ask management, audit committees, internal auditors, and other contractor personnel, as deemed appropriate, about their views of fraud risks. DCAA added this requirement in January 2004, to incorporate revisions that the AICPA made to its auditing standard on the auditor’s responsibility relating to fraud. An auditor should use the information gained from such inquiries to properly plan individual examination assignments by designing specific steps to detect material instances of potential fraud, illegal acts, or violations of contract provisions. Therefore, the six audit offices did not fully comply

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engagements by designing steps that would provide a reasonable assurance of detecting fraud, illegal acts, or violations of contract provisions having a material effect on the assertion or subject matter being reviewed.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 8.**

**The Director, Defense Contract Audit Agency should:**

**(a.) issue a memorandum to all field audit offices reminding them of the requirement to ask appropriate contractor representatives about their knowledge of fraud risks,**

**(b.) revise the Annual Planning Document to include a reminder of the requirement, and**

**(c.) require the Regional Directors and Director, Field Detachment to establish a monitoring process to verify that the requirement is properly implemented.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans nonconcurrent with the recommendations. DCAA stated that the AICPA requirement is applicable only to financial audits and after reassessing their policy decided to eliminate their requirement to address fraud indicators at annual planning meetings with contractors.

**DoD IG Response.** We are disappointed that DCAA chooses to eliminate their requirement. The DCAA guidance showed a proactive position regarding fraud awareness and the identification of fraud indicators and detection. We believe that the knowledge gained from the discussions with contractor management regarding fraud risks enhanced auditors' ability to design specific programs for assignments. DCAA should reconsider their decision to eliminate this guidance and instead enforce the implementation of the guidance fully as recommended.

## **Documentation**

**9. Sampling Plans.** In 54<sup>13</sup> of 61<sup>14</sup> assignments where DCAA used either statistical or judgmental sampling, the auditor did not properly document the sampling plan used as required by GAGAS and DCAA policies and procedures. GAGAS requires the attest documentation to include any sampling and other criteria used to select items for review in the documentation of the objectives, scope, and methodology of the engagement. DCAA policies and procedures require the following information be documented when statistical sampling is used.

- a. the general objective of the sample;
- b. the specific characteristics to be tested for;

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<sup>13</sup> Auditors used statistical sampling in 2 assignments and judgmental sampling in the remaining 52 assignments.

<sup>14</sup> Of the 61 assignments, the auditors used statistical sampling in 5 assignments and judgmental sampling in 56 assignments.

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- c. a description of the universe (scope, size, and sampling unit) and the sampling frame;
  - d. the determination as to whether the universe reconciles with the sampling frame and what remedies, if any, were developed and used;
  - e. the selected sampling approach and its suitability;
  - f. the desired values for sampling reliability parameters;
  - g. the determination of how the sample size is consistent with the objective;
  - h. the sample selection method which includes either the sampling software procedure or a description of the universe stratification process and the way sample items are randomly selected; and
  - i. the specific software to be used for sample evaluations.

Auditors used judgmental sampling in the majority of the examinations and reviews that we evaluated. Adequate judgmental sampling plan documentation should also include the majority of the items listed above; however, DCAA guidance only infers that an auditor must adequately document a judgmental sampling plan and does not specify what adequate documentation includes. Therefore, it is especially important that DCAA clarify the existing guidance on judgmental samples.

DCAA uses sampling to satisfy the objectives, support favorable resolution of any reported conditions, and balance risk and limited auditor time on individual assignments. Adequately documented sampling plans provide a clear understanding of the objective, scope, and methodology, and enable a reviewer to determine whether the evidence gathered is sufficient to support the auditor's conclusions. Without adequate documentation, a reviewer may be unable to determine whether, for an examination, the auditor has gathered sufficient evidence to render a positive opinion.

In future reviews, inadequate documentation of sampling plans could result in a determination that the evidence or support in the working papers was insufficient and did not support the findings and conclusions in the report. This determination could lead to a recommendation that DCAA rescind reports or perform additional work to support the findings and conclusions in the reports. Therefore, DCAA must emphasize to its auditors and managers the importance of adequately documenting both types of sampling plans.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 9.**

**The Director, Defense Contract Audit Agency should:**

**(a.) revise the current working paper checklist to include specific documentation questions relating to the sampling plan design and the selection and use of appropriate sampling methods for achieving objectives,**

**(b.) require that each regional and Field Detachment management provide all its audit staff, supervisors, and managers a headquarters-provided revised training session on the proper documentation of sampling plans and the selection and use of appropriate sampling methods for achieving objectives,**

**(c.) require all regional and Field Detachment management to monitor use and documentation of judgmental and statistical sampling in assignments, and**

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**(d.) revise the current guidance in the Contract Audit Manual to clarify the requirement to document judgmental sampling plans and specify what must be included in adequate documentation for a judgmental sampling plan.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans concurred with recommendation (a.) and plans to revise the audit peer review working paper checklist to include a question on documentation of the sample plan by July 2007. DCAA partially concurred with recommendation (b.). DCAA is currently reviewing their guidance on sampling with the intent to clarify and plans to provide training by December 2007, on resulting changes to guidance. DCAA concurred in principle with recommendation (d.) and will make necessary clarification to guidance on documentation of sampling by October 2007. DCAA nonconcurred with recommendation (c.) because they believe that reviewing the documentation of sampling used and the assignments compliance with GAGAS and Agency policy is fundamentally the responsibility of the supervisor.

**DoD IG Response.** We accept the proposed DCAA actions for recommendation (a.), (b.), and (d.) as satisfying the intent of the recommendations. The DCAA position that supervisors are fundamentally responsible for ensuring assignments comply with GAGAS and Agency policies, ignores the number of deficiencies identified and the need to take additional action to supplement the supervisory reviews. DCAA should reconsider its position on recommendation 9(c.).

## **Reporting**

**10. Use of Samples.** DCAA reports issued on attestation examinations and reviews in which an auditor used either statistical or judgmental sampling methods do not fully comply with GAGAS because DCAA guidance only requires the auditor to include in the scope paragraph the general statement “tests of appropriate records, internal controls, accounting principles and operations were made as necessary.” Therefore, the auditor does not have to fully disclose or describe the use of sampling plans in the scope of work performed, methodology, or explanatory notes on findings and conclusions. In addition, DCAA guidance does not provide the auditor with any specific guidance on reporting the use of judgmental samples and is inconsistent as to what information on statistical sampling methods and results the auditor should provide in a report.

DCAA should clarify its guidance on reporting statistical sampling results which is currently inconsistent. For instance, the CAM in one section provides that the auditor should report when statistical sampling was used; however, elsewhere it allows the auditor to make the decision whether to provide that information. Different sections of CAM are also inconsistent as to what additional information the auditor should provide. In one section, the guidance instructs the auditor to use only one projected amount or value when questioning costs, but not to provide additional information on the sampling plan used such as the confidence level or interval or other sampling plan details. While in another chapter, the guidance states that the auditor should not only provide the value or amount but also explain how the auditor calculated the questioned amount or value. When projecting the results of a statistical sampling method across a universe is inappropriate, the guidance requires the auditor to explain why it was inappropriate.

The current DCAA guidance does not fully comply with GAGAS for attestation engagements requirements that the report include a description of the nature and scope of work performed and auditors should put findings into perspective by describing them in



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relation to the population or the number of cases examined and quantifying them in terms of dollar value when appropriate. When sampling significantly supports the findings, GAGAS for performance audits requires the auditor to describe the methodology used by including a description of the sample design, the reason for choosing it, and whether the results could be projected to the intended population. Therefore, one can reasonably infer that the same level of detail should be expected in attestation engagement reports. Thus, DCAA reports did not fully comply with GAGAS or its intent when the auditor used sampling techniques to perform the engagement but did not fully disclose them in the report. DCAA should revise agency guidance to require auditors to fully disclose the use of sampling in reports when describing the scope, methodology, findings and conclusions on which they based their opinion.

## **Recommendations, Management Comments, and DoD IG Response**

### **Recommendation 10.**

**The Director, Defense Contract Audit Agency should revise the Contract Audit Manual to:**

**(a.) require auditors to fully describe the use of sampling methods when reporting the scope, methodology, findings, and conclusions on which the opinion expressed is based, and**

**(b.) eliminate any inconsistency in the guidance on reporting the use of sampling methods.**

**Management Comments.** The DCAA Assistant Director for Policy and Plans partially concurred with recommendation (a.). DCAA plans to assess their guidance by October 2007, on the sampling information to include in audit reports when findings are based on the use of sampling techniques. However, DCAA disagreed with the extent of detail regarding the sampling that should be included in the report. DCAA concurred with recommendation (b.) and agreed to eliminate any inconsistencies in DCAA guidance on reporting the use of sampling methods.

**DoD IG Response.** We accept the DCAA proposed actions as satisfying the intent of the recommendations. However, DCAA should require auditors to fully and clearly disclose the nature and scope of work performed in their reports.

## Appendix B. Scope and Methodology

We performed this review of the DCAA Quality Control System from January 2006 through April 2007, using standards and guidelines established in the April 2005 President's Council on Integrity and Efficiency (PCIE) "Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General" as adjusted for the types of reviews DCAA performs. We considered the requirements of quality control standards and other auditing standards contained in the 2003 Revision of the GAS issued by the Comptroller General of the United States. GAGAS 3.52 states:

The external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Audit organizations should take remedial, corrective actions as needed based on the results of the peer review.

The DCAA has 78 field audit offices, which performed 36,840 audit assignments from October 1, 2005, through September 30, 2006. We judgmentally selected six field audit offices, one office in each of the five DCAA regions and Field Detachment (classified audits). We selected five field audit offices that the DCAA headquarters-led quality assurance team did not review and one office that they did review during its second cycle review. At each reviewed office, we judgmentally selected an average of 23 assignments representing a cross-section of the different assignments that various teams and supervisory auditors performed. The table below shows the number of each assignment reviewed at each location.

**Assignments Reviewed By Location**

<b>Assignment Type</b>	<b>Western Region</b>	<b>Eastern Region</b>	<b>Mid Atlantic Region</b>	<b>Field Detachment Region</b>	<b>Central Region</b>	<b>Northeastern Region</b>	<b>Total</b>
Forward Pricing	5	4	6	4	4	4	27
Incurred Cost	5	4	2	4	4	1	20
Internal Control	5	4	4	4	4	3	24
Cost Accounting	2	2	2	2	2	1	11
All Other	8	6	6	3	8	7	38
AUPs	3	3	4	3	5	3	21
<b>Total</b>	<b>28</b>	<b>23</b>	<b>24</b>	<b>20</b>	<b>27</b>	<b>19</b>	<b>141</b>

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In performing our review, we assessed, reviewed, and evaluated:

- the adequacy of the design of policies and procedures that the DCAA established to provide reasonable assurance of compliance with GAGAS in the conduct of its audits and attestation engagements;
- the DCAA headquarters-led quality assurance reviews including participating and observing their field work during 4 field audit office visits and monitoring their work and followup on previous recommendations from 2003 to 2006;
- the internal procedures for monitoring, on an ongoing basis, whether the DCAA quality control system is suitably designed and effectively applied;
- the DCAA audit staff's understanding of quality control policies and procedures;
- the independence documentation and records of continuing professional education to verify the measures that enable the identification of independence impairments and maintenance of professional competence;
- the regional quality control programs for each of the field audit offices visited; and
- 141 assignments and related project documentation to determine whether established policies, procedures, and applicable standards were followed.

**Limitations of Review.** Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance with it because we based our review on selective tests. Inherent limitations exist when considering the potential effectiveness of any quality control system. Departures from GAGAS can result from misunderstood instructions, mistakes in judgment, carelessness, or other human errors. Projecting any evaluation of a quality control system is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)/Chief Financial Officer

### **Other Defense Organizations**

Director, Defense Contract Audit Agency

### **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Homeland Security and Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Oversight and Government Reform

House Subcommittee on Government Management, Organization, and Procurement

Committee on Oversight and Government Reform

House Subcommittee on National Security and Foreign Affairs, Committee on Oversight  
and Government Reform

House Subcommittee on Information Policy, Census, and National Archives, Committee  
on Oversight and Government Reform

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# Appendix D. Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PQA 720.7.a.225.5 [D2006-DIPOAC-0133.000]

April 12, 2007

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY AND  
OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL,  
DEPARTMENT OF DEFENSE

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG), *Review of the Defense Contract Audit Agency Quality Control System*, dated March 14, 2007  
(Project No. D2006-DIPOAC-0133.000)

Thank you for the opportunity to respond to the subject draft report, *Review of the Defense Contract Audit Agency Quality Control System*, and appendix, entitled *Comments, Observations, and Recommendations*. The following are DCAA's clarifying remarks to specific statements in the narrative sections of the draft report and DCAA's responses to each of the ten separate recommendations.

## Quality Control and Assurance

### 1. Independent Internal Quality Assurance Review of Field Detachment Offices.

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should revise the headquarters-led quality assurance review process and obtain the needed security clearances and billets so that:

- a. the Chief, Quality Assurance Division, Policy and Plans, has the required clearance(s) for access to Field Detachment (FD) work, and
- b. more than one headquarters or regional quality assurance auditors can participate in the headquarters-led internal quality assurance reviews of Field Detachment offices.

**DCAA Response: Partially concur.** DCAA disagrees with the DoDIG recommendation to have the Chief, Quality Assurance Division (PQA), obtain a security clearance to participate in the internal Quality Assurance reviews of Field Detachment offices. Based on our experience, the PQA Chief is able to perform adequate reviews of the PCIE-based review results without the need for a security clearance. DCAA also disagrees with the DoDIG's narrative comments recommending a Regional or Headquarters QA staff member review unclassified audits when they are able to gain access to the FD audit or facilities. DCAA believes it will serve limited additional benefit considering the risk of potential disclosure of classified information.

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As discussed in the DoDIG narrative, the DCAA process already requires the participation of a cleared independent Headquarters PQA staff member in all the FD PCIE-based reviews. We believe that this individual's participation in FD PCIE reviews will resolve any potential FD QA independence issues. However, in consideration of the DoDIG's concern relative to the timing necessary to obtain a security clearance and the potential for future staff changes, by June 2007, we will commence the process to obtain a security clearance for a second member of the Headquarters PQA staff.

## 2. Quality Assurance Program Coverage of Internal Control System Reviews.

**DCAA Comments on Report Narrative:** DCAA disagrees with the DoDIG narrative comments on the DoDIG review of Internal Control System Reviews (ICSRs), which concludes that DCAA reduced the coverage of ICSRs to an inappropriate level during the second round of PCIE-based reviews. For the second cycle, we based the number of system audits reviewed on the percentage of direct audit hours charged to system reviews (8.5%) and a reduction in scope since we found a relatively low rate of noncompliance during the first cycle of reviews. We also disagree with the DoDIG comments/conclusions on the ICSRs reviewed by the DoDIG. For some of the audits, the DoDIG concluded that DCAA inappropriately opined on the adequacy of a contractor's system because of insufficient compliance testing or other evidence issues. When evaluating the adequacy of compliance testing, we do not believe the DoDIG fully considered testing that is performed in other related audits for some of these assignments.

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency should provide Headquarters Quality Assurance Division with additional staff so that at least 12 audit offices and 72 internal control system reviews can be reviewed during the third quality control cycle of internal control system reviews.

**DCAA Response: Partially concur.** DCAA recognizes the importance of ICSRs in assessing audit risk at major contractor locations and agrees to increase the number of FAOs and assignments reviewed during the current round of Quality Assurance (QA) reviews of internal control audits. We will expand our review commensurate with the number of ICSRs performed by region and related risk.

## 3. Quality Assurance Program Followup on Repeat Noncompliances at Audit Offices.

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should revise the existing headquarters-led quality assurance review process starting with followup actions for the second round so that either a Regional or Headquarters QA staff member would evaluate the effectiveness of corrective actions planned or implemented by each audit office for all repeat noncompliances.

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**DCAA Response: Partially concur.** DCAA agrees that follow-up on FAOs' corrective action plans to identified repeat noncompliances is appropriate. However, we disagree with implementing the DoDIG's recommendation on a retroactive basis as we believe it would be a more efficient use of resources to implement the DoDIG's recommendations on a prospective basis. Therefore, DCAA partially concurs with the recommendation and agrees to revise the PCIE Quality Assurance process beginning with the third cycle, which began in October 2006, to require that a Regional Quality Assurance staff member evaluate the effectiveness of corrective actions implemented by audit offices for repeat noncompliances.

#### **Types of Attestation Engagements**

#### **4. Desk Reviews of Contractor Incurred Cost Submissions Under \$15 Million.**

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency should suspend the performance of desk reviews until agency guidance on performing desk reviews are issued that complies with Generally Accepted Government Auditing Standards (GAGAS).

**DCAA Response: Concur in principle.** DCAA Headquarters initiated a comprehensive study of the DCAA guidance for low risk desk reviews. As a result of this study, we issued audit guidance on April 11, 2007, which requires that low risk desk reviews be closed by issuing a memorandum to the ACO which does not state that the review was performed in accordance with GAGAS (MRD 07-PPD-011). The guidance was made effective immediately.

#### **5. Contract Audit Closing Statement Assignments.**

**DCAA Comments on Report Narrative:** The narrative discussion includes comments that DCAA Contract Audit Closing Statements (CACS) are not performed in compliance with GAGAS if they largely rely on other completed audits. We disagree with this conclusion. As previously discussed with the IG representatives, we believe that the GAGAS evidence standard provides for relying on work performed in other audits as appropriate evidence.

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should:

- a. determine whether contract audit closing statement reviews should be performed in compliance with Generally Accepted Government Auditing Standards, and, if so, as what type of attestation engagement, and
- b. revise the Contract Audit Manual guidance, standard audit programs, pro forma reports, and training for performing contract audit closing statements are revised based on that decision.

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**DCAA Response: Concur.** DCAA Headquarters has already initiated a comprehensive study of the DCAA guidance for CACS assignments and the appropriateness of performing CACS with Quick Closeout Rates as either examinations or agreed-upon procedures engagements. Once the study is completed, DCAA will make appropriate revisions to the DCAA audit guidance related to performance of CACs and quick closeout CACS. Our revisions will include the pertinent sections of the CAM, APPS audit programs and report shells. This action is scheduled for completion by October 2007.

**6. Agreed-Upon Procedures Engagements.**

**DCAA Comments on Report Narrative:** As previously discussed with the DoDIG, we disagree with some of the comments contained in the report narrative. In particular, DCAA believes that our current CAM guidance does comply with GAGAS, but we acknowledge that it can be improved and we are in the process of making such a revision. DCAA believes that the AUP standard audit report (code 28000) appropriately differentiates between an examination and an Agreed-Upon Procedures report. DCAA has already made numerous changes to the report format to comply with AICPA Statements on Standards for Attestation Engagements (SSAE) 201.31, Agreed-Upon Procedures (AUP) Engagements Reporting Required Elements. Based on the changes DCAA already implemented, we do not understand what additional changes the DoDIG believes are required.

In addition, we do not completely agree with the DoDIG's statement that some of the AUP reports were misleading, inaccurate, or incomplete. While we concur that some of the reports did not fully comply with GAGAS, we do not agree that the reports were misleading, inaccurate or incomplete. We believe the majority of the AUP reports were supported by appropriate evidence and provided the information requested by the customer.

**DoDIG Recommendation.** The Director, Defense Contract Audit Agency, should:

- a. revise all guidance on performing agreed upon procedures engagements in a separate Contract Audit Manual chapter or section of a chapter solely devoted to agreed upon procedures engagements, and
- b. revise the agreed upon procedures pro forma report so that it complies with Generally Accepted Government Auditing Standards and is easily distinguished from other standard audit report formats,
- c. identify and track all assignments performed as agreed upon procedures engagements in the agency management information system, and
- d. require regional and Field Detachment management to monitor on an ongoing basis agreed upon procedures engagements to ensure that they are performed in compliance with



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Generally Accepted Government Auditing Standards until the headquarters-led quality assurance review team completes the third cycle reviews.

**DCAA Response:**

a. **Concur.** Headquarters, DCAA, has already initiated a comprehensive revision to the DCAA audit guidance related to AUPs for inclusion in CAM Chapter 14. The revision consolidates guidance for various types of AUPs in one location. However, under this revision, reporting guidance will remain in CAM Chapter 10. This action is scheduled for completion by September 2007.

b. **Nonconcur.** As stated above, we believe the AUPs pro forma report complies with GAGAS.

c. **Partially concur.** DCAA already has the ability to track the majority of the assignments performed as AUPs in the DMIS under 5 digit codes 17900 and 28000. As we previously discussed with the DoDIG, we are able to extract the Code 17900 AUPs due to the information collected under the APPS tab of DMIS. DCAA believes that these two 5-digit codes represent the majority of the AUP assignments. Nonetheless, the DoDIG indicated that they are concerned that DCAA does not actually know the numbers of AUPs performed, since they could be performed under some other 5-digit code. DCAA does not believe it would be cost effective to reprogram DMIS to accomplish this tracking, but agrees to re-assess our policy for performing AUPs under other 5-digit codes as part of the review of audit guidance discussed in paragraph a. above.

d. **Partially concur.** DCAA agrees to continue monitoring AUP engagements until DCAA management is satisfied that DCAA has improved its compliance with GAGAS to a satisfactory level. This monitoring has been implemented as a result of an Executive Steering Committee action item requiring each Region/FD to implement a quality control procedure for planning, performing and reporting AUPs assignments. (These quality control procedures have been provided to the DoDIG.) By the end of first quarter FY 2008, PQA will perform a follow up desk review of AUPs to determine if the monitoring has improved performance of AUPs, and provide a recommendation to DCAA management as to whether continued monitoring is necessary.

**Criteria**

**7. Identification of Criteria.**

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should revise the Contract Audit Manual to require auditors to identify the specific criteria actually used in the

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performance of attestation examinations and reviews either on the planning document working paper or in the scope section of working papers.

**DCAA Response: Nonconcur.** DCAA disagrees with the DoDIG report narrative statement that DCAA guidance on working paper documentation does not fully comply with the GAGAS. GAGAS does not provide specific requirements on the level of specificity of criteria. GAGAS 6.03 states "The AICPA general standard related to criteria states the following: The practitioner [auditor] shall perform an engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users." DCAA guidance already requires that the working papers document the authoritative criteria being used in the audit procedures when testing for compliance. DCAA believes a general reference to the applicable body of regulations (e.g., FAR, CAS) is sufficient, except where noncompliant practices or cost questioned are identified. In these cases, the specific FAR provision (e.g., FAR 31.205-33) should be cited in the working paper detail. We concur that the applicable non-DoD regulations should be referenced in the report and working papers in accordance with Agency policy. In reference to the FD reports applicable to the other Agency supplements, in December 2006, FD issued a policy requiring the documentation of the applicable agency supplement in the working papers.

#### **Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, and Abuse**

##### **8. Planning, Risk Assessment, and Designing Tests.**

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency should:

- a. issue a memorandum to all field audit offices reminding them of the requirement to ask appropriate contractor representatives about their knowledge of fraud risks,
- b. revise the Annual Planning Document to include a reminder of the requirement, and
- c. require the Regional Directors and Director, Field Detachment to establish a monitoring process to verify that the requirement is properly implemented.

**DCAA Response: Nonconcur.** DCAA disagrees with all three recommendations and also disagrees with the report narrative characterization that the planning meeting inquiry regarding the risk of fraud is a required step in the proper planning of examinations under GAGAS. In every DCAA examination the auditor is required to assess the risk for fraud, as required by the GAGAS. In addition to this requirement, although not required by GAGAS, DCAA implemented a policy for auditors to make inquiries of management on their knowledge of fraud risks during its annual planning meeting with its major contractors. Since this requirement applies only to financial statement audits and duplicates other effort performed by the auditor, we have re-assessed this policy and have eliminated this requirement.

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## Documentation

### 9. Sampling Plans.

**DCAA Comments on Report Narrative:** DCAA disagrees with the DoDIG's narrative comments as we believe the DoDIG is incorrectly applying the GAGAS requirements for statistical samples to judgmental samples/selections. The audits referenced in the opening paragraph predominantly used judgmental sampling/selections (i.e., only 2 out of 54 used statistical sampling). We disagree with the statements in the narrative that conclude that the DCAA guidance does not comply with GAGAS where an auditor used judgmental sampling/selections. GAGAS does not specify the level of detail required to document judgmental sampling plans. The majority of DCAA engagements fall under GAGAS Chapter 6, which states that attest documentation should include "the objectives, scope, and methodology of the attestation engagement, including any sampling and other selection criteria used." We do not agree with the DoDIG's statement that adequate judgmental sampling plan documentation should include the majority of the items that are included for statistical sampling. As part of our review to clarify guidance related to judgmental sampling as discussed below, we will assess what information should be included in judgmental sampling plan documentation.

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should:

- a. revise the current working paper checklist to include specific documentation questions relating to the sampling plan design and the selection and use of appropriate sampling methods for achieving audit objectives,
- b. require that each region and Field Detachment management provide all its audit staff, supervisors, and managers a headquarters-provided revised training session on the proper documentation of sampling plans and the selection and use of appropriate sampling methods for achieving audit objectives,
- c. require all Regions and Field Detachment management to monitor use and documentation of judgmental and statistical sampling in audit assignments, and
- d. revise the current guidance in the Contract Audit Manual to clarify the requirement to document judgmental sampling plans and specify what must be included in adequate documentation for a judgmental sampling plan.

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**DCAA Response:**

- a. **Concur.** By July 2007, PQA will revise the audit working paper checklist used in the peer review process to include a question relating to the documentation of the sampling plan.
- b. **Partially concur.** DCAA is in the process of reviewing the guidance related to sampling with the intention of clarifying the guidance. By December 2007, DCAA agrees to provide training on any substantive changes to the current guidance.
- c. **Nonconcur.** DCAA disagrees with the recommendation to require all regions and Field Detachment to monitor the use of sampling. We do not believe the significant effort that would be required would be a prudent use of Government and audit resources. We believe this effort is a fundamental responsibility of a supervisory auditor as part of their responsibility to review the audit assignment for compliance with GAGAS and Agency policy.
- d. **Concur in Principle.** As stated in our response to b. above, DCAA is in the process of reviewing the guidance related to sampling with the intention of clarifying the guidance. Based on this review, by October 2007, DCAA will make the necessary clarifications to the guidance relating to the documentation of sampling plans. We do not agree with the items identified by the DoDIG as being required for adequately documenting a judgmental sampling/selection plan. As part of our review, we will assess as to whether we believe the required items should be included in the judgmental plan documentation.

**Reporting**

**10. Use of Samples.**

**DCAA Comments on Report Narrative:** DCAA disagrees with the DoDIG conclusion that the audit reports reviewed by the DoDIG do not comply with GAGAS where an auditor used sampling. The DoDIG conclusion is based on applying information in the performance audit section of the Yellow Book. The majority of DCAA engagements fall under GAGAS Chapter 6, on Attestation Engagements, which incorporates the AICPA Reporting Standards for Attestation Engagements (SSAEs) at 6.27. Additional GAGAS reporting Standards for Attestation Engagements are contained in GAGAS 6.28 – 6.54. This applicable GAGAS section and related Attestation Standards (AT 101.84 - .87) do not contain any specific requirements for reporting on sampling. We disagree with the DoDIG report statements that information in the GAGAS chapters on performance audits is applicable to DCAA attestation engagements.

PQA 720.7.a.225.5 [D2006-DIPOAC-0133.000]

April 12, 2007

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG)  
Memorandum, *Review of the Defense Contract Audit Agency Quality Control System*,  
dated March 14, 2007 (Project No. D2006-DIPOAC-0133.000)

**DoDIG Recommendation:** The Director, Defense Contract Audit Agency, should revise the Contract Audit Manual to:

- a. require auditors to fully describe the use of sampling methods when reporting the scope, methodology, findings, and conclusions on which the opinion expressed is based, and
- b. eliminate any inconsistency in the guidance on reporting the use of sampling methods.

**DCAA Response:**

a. **Partially Concur.** As stated above, we disagree with the DoDIG on the extent of detail required in the audit report when findings are based on the use a sampling techniques. We agree that if findings are based on the use of sampling, the overall sampling approach should be discussed in the report, without going into excessive technical details. By October 2007, DCAA will assess the current guidance and assess the need to clarify guidance on the sampling information to include in audit reports when audit findings are based on the use of sampling techniques.

b. **Concur.** By October 2007, as part of our review of current sampling guidance discussed in a. above, DCAA agrees to eliminate any inconsistencies in the DCAA guidance on reporting the use of sampling methods.

Questions regarding this memorandum should be directed to Ms. Mary Silva, Chief, Quality Assurance Division, at (703) 767-2298.

/Signed/  
Kenneth J. Saccoccia  
Assistant Director  
Policy and Plans



# Inspector General Department of Defense

