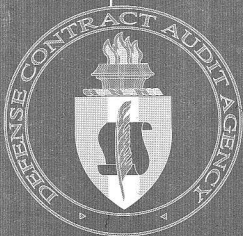


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DCAA CONTRACT AUDIT MANUAL

**Vol. 2 of 2
Chapters 9-15
Appendixes A-I
Topical Index**

**DEPARTMENT OF DEFENSE
DEFENSE CONTRACT AUDIT AGENCY**

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DCAA CONTRACT AUDIT MANUAL

**Vol. 2 of 2
Chapters 9-15
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Topical Index**

**DEPARTMENT OF DEFENSE
DEFENSE CONTRACT AUDIT AGENCY**

DCAA CONTRACT AUDIT MANUAL

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CHAPTER 9

9-000 Audit Of Cost Estimates And Price Proposals

9-001 Scope of Chapter

a. This chapter presents guidance for evaluating estimates of cost and profit supporting price proposals submitted by contractors in connection with the award, administration, modification, or repricing of Government contracts. The guidance applies to audit of estimates submitted in connection with negotiation of the following:

- (1) prices of firm-fixed-price contracts;
- (2) initial and adjusted prices of redeterminable fixed-price contracts;
- (3) initial and successive target costs of incentive fixed-price and incentive cost-reimbursement contracts;
- (4) estimated costs of cost-plus-fixed-fee contracts;
- (5) prices of spare parts;
- (6) contract change proposals;
- (7) rates for time and material and technical services contracts;
- (8) claims for price adjustments due to abnormal events;
- (9) economic price adjustments;
- (10) price adjustments pursuant to Cost Accounting Standards clauses; and
- (11) advance agreements on forward pricing factors such as indirect cost rates, labor hour rates, material handling rates, and other elements of pricing formulas to be used repetitively.

b. Section 1 discusses administrative procedures for field pricing support; that section includes coverage of requests to provide specific cost information and to assist higher-tier contractors audit proposals submitted by subcontractors. Section 2 provides guidance in evaluating the adequacy of cost or pricing data in the proposal. Section 3 discusses general evaluation procedures for estimates. Sections 4 through 7 present specific guidelines for evaluating cost estimates for direct labor, direct material, other direct costs, and indirect costs. Section 8 presents special considerations in pricing the impact of inflation, including the audit of proposed contractual economic price adjustment provisions. Profit evaluation assistance to the contracting officer is discussed in Section 9. Section 10 highlights criteria for audit of estimates derived from cost estimating relationships that involve noncost variables. Section 11 is reserved. Section 12 provides guidance in evaluating forward pricing rate agreements. Section 13 provides guidance for DCAA participation as a member of a should-cost audit team.

9-002 Related Audit Guidance

a. Chapter 5-1200 covers Audits of Estimating System Internal Controls. It presents procedures applicable to comprehensive team surveys of contractor estimating systems by auditors and technical specialists.

b. Audit report preparation is covered in Chapter 10. Since audit reporting requirements affect the fieldwork required, be familiar with Chapter 10 provisions applicable to the proposal at hand before you begin the proposal audit.

c. Appendix E and Appendix F, which describe graphic and computational analysis and improvement curve analysis techniques as evaluation tools, should be used in conjunction with this chapter.

d. Throughout this chapter, various Cost Accounting Standards are cited. Refer to the complete text of CASB Rules, Regulations and Standards and to Chapter 8 for audit guidance on CAS.

e. The DCAA Intranet and the APPS software provide an audit program to examine price proposals which is to be tailored to the specific circumstances and an audit program

for the examination of proposals under \$5 million, under activity code 21000. When appropriate, the DCAA Intranet and the APPS application software should be used to expedite:

- (1) rate applications;
- (2) audit summarization; and
- (3) preparation of summary working papers, audit report exhibits, and rate schedules.

f. Chapter 4-403 covers the format and contents of working papers. Standardization in design, content, and arrangement facilitates audit, supervision, and report preparation.

g. As part of planning the audit of a price proposal, brief the request for proposals in accordance with 3-203. During each audit of cost estimates or price proposals, observe any operations security (OPSEC) measures required by current DoD contracts or requests for proposals, in accordance with 3-205.

h. While auditing the price proposal, if anticompetitive procurement practices are suspected, refer to 4-705 for audit guidance.

9-003 The Total Audit Environment

a. The guidance in this chapter should be applied to the audit of individual proposals with due regard for the audit environment, considering previous audit experience with the contractor and the materiality of the various elements of the proposal. A detailed evaluation of each element of every proposal submitted for audit is normally unnecessary.

b. Make full use of all relevant knowledge about the contractor which has been documented in prior audits. This would include:

- (1) The strengths or weaknesses of the contractor's estimating system, which may also be the subject of a separate examination (see 5-1200).
- (2) The general credibility of the contractor's proposals, as determined in the course of previous proposal evaluations and postaward audits. (When a contractor's accounting practices or representations of historical and projected costs repeatedly contain significant deficiencies, errors, or unreasonable estimates which suggest either negligence or an apparent intent to deceive the Government, such cases are reportable under 4-700.)
- (3) The reliability of the contractor's cost accounting system.
- (4) Current trends in the contractor's labor, indirect cost, or other costs, as reflected in the results of recent proposal evaluations or audits of incurred costs.
- (5) Current changes in and/or modernization of the contractor's manufacturing practices as noted during tours of the manufacturing floor, perambulations, and in the results of estimating surveys, recent proposal evaluations, or audits of incurred costs. (Changing the flow of how products are made can affect the flow of costs (see 14-800).)
- (6) Cost avoidance recommendations made as a result of operations audits (see 14-500).

9-100 Section 1 --- Administrative Procedures for Field Pricing Support

9-101 Introduction

a. This section presents the general procedures for processing requests for advisory audit reports and other contract audit information related to contractor and subcontractor price proposals. Basic guidance on audit fieldwork and preparation of audit reports is not repeated in this section (see subsequent sections of this chapter and 10-300).

b. The term "PCO" is also applied to a plant representative/ACO who has been delegated procurement authority to execute the particular contract action.

9-102 The Field Pricing Support Concept

9-102.1 The Approach

a. FAR 15.4 and DFARS 215.4 describe the responsibilities and functions for the audit, analysis, and negotiation of price proposals, and related matters concerning negotiated procurements. Much of this guidance applies to all types of negotiated pricing actions, including contract price redetermination after costs have been incurred under the contract. However, certain requirements may apply only to the initial pricing of contracts, contract additions, or contract modifications (sometimes called forward or pre-award pricing actions).

b. Field pricing support consists of all audit and other specialist effort necessary for the contracting officer to determine the reasonableness of the proposed cost or price. FAR 15.404-2 assigns the contracting officer responsibility for determining the extent of field pricing support required, and for establishing the specific areas in which audit input is needed. This usually results in a request to DCAA to provide field pricing assistance. DCAA provides the following forward pricing services:

Type of Service	Scope of Service	Contractor's Supporting Documentation	Type of Report Statement	Reporting	CAM Cite
Specific Cost Information [Code 25000]	Provide existing data in FAO files, or additional services that can be provided in 4 hours or less	Cost or pricing data; information other than cost or pricing data	None	Telephone with written confirmation memorandum	9-107
Application of Agreed-Upon Procedures [Code 28000]	Performance of specific procedures agreed-upon in advance with the customer	Cost or pricing data; information other than cost or pricing data	Disclaimer	Report	9-108 9-209
Cost Realism Analysis [Code 28000]	Evaluation to ascertain potential cost understatement	Information other than cost or pricing data	Disclaimer	Report	9-108 9-311.4

Type of Service	Scope of Service	Contractor's Supporting Documentation	Type of Report Statement	Reporting	CAM Cite
Audit of Part of a Proposal [Code 27000]	Examination of one or more cost elements or parts of a cost element, e.g., rates or the bases, but not the entire proposal	Cost or pricing data on the part(s) to be examined; information other than cost or pricing data on the part(s) to be examined (cost information only)	Opinion only on the part(s) of the proposal examined	Report	9-108 9-210
Complete Proposal Audit [Code 21000]	Examination of an entire proposal	Cost or pricing data; information other than cost or pricing data (cost information only)	Opinion on proposal as a whole	Report	Chap. 9
Audit of Forward Pricing Rates [Code 23000]	Examination of a contractor's direct and indirect rates (generally in support of forward pricing rate agreements or informal rate recommendations, however, a request to examine an individual price proposal can trigger a Code 23000 audit if the results are expected to form the basis for subsequent audit rate recommendations related to other price proposals)	Cost or pricing data; information other than cost or pricing data (cost information only)	Opinion on the rates examined	Report	9-700 9-1200

Type of Service	Scope of Service	Contractor's Supporting Documentation	Type of Report Statement	Reporting	CAM Cite
Integrated Product Team (IPT) [Code 22000]	Auditor effort expended participating on a formally chartered IPT which culminates in either a full examination of a proposal, examination of a part of a proposal, or an application of agreed-upon procedures	Cost or pricing data; information other than cost or pricing data (cost information only)	Statement based on the services performed (refer to boxes for 21000, 27000, or 28000 as applicable)	Report	1-802 1-803

A clear understanding of the requestor's needs is essential for establishing the scope for audits of proposals for either prime contracts or subcontracts as discussed in 9-103.3 and 9-104.2. When significant contractor deficiencies or system problems exist, the auditor should explain them to the contracting officer and discuss the potential for additional audit coverage. When a request is received for an examination of the entire proposal and there is little risk involved, discuss with the requestor if their needs could be met by other services such as examining part of the proposal (9-108) or providing specific cost information (9-107). See 4-103 for guidance on preparing acknowledgment and notification letters. There are special requirements for reporting on an examination of a part of a contractor's proposal as stated in 9-108, 9-206, 9-207, and 10-300.

c. FAR 15.404-2(a)(3) encourages contracting officers to team with appropriate field experts throughout the acquisition process, including negotiations. Early communication among team members assists in determining the extent of assistance required, the specific areas for which assistance is needed, a realistic audit schedule, and the information necessary to perform the field pricing assistance audit. The Defense Contract Management Agency (DCMA) advocates use of Integrated Product Teams (IPTs) whenever possible (See 1-800). DCMA no longer prepares traditional field pricing reports which integrate both technical and pricing aspects. FAR 15.404-2(b)(ii) does not require that field pricing assistance reconcile technical and audit recommendations. When the PCO determines that audit support is required, then the PCO will send the audit request directly to the cognizant audit office. The PCO sends requests for field pricing support services broader than audit services to the plant representative/ACO, with a copy to the cognizant contract audit office; the contract auditor shall treat the advance copy of the PCO request as a signal to begin the audit work. DCMA policy is that requests for DCAA audit will be forwarded to the cognizant FAO and the requestor be apprised of such action and advised that future requests may be sent directly to DCAA. If after receiving an advance request there is concern about whether an audit will be necessary, immediately discuss the matter with the ACO. Any uncertainty about whether an audit will be needed should be resolved in favor of starting the audit. If the ACO states that an audit will not be requested, contact the PCO to determine whether ACO actions will be sufficient. If the PCO states that an audit is necessary, it should be performed as a direct request in accordance with FAR 15.404-2(c) and the ACO should be so advised (see 9-103.1d.(7)).

d. The field pricing support process is conducted as a cooperative team effort in order to ensure timely and effective response to the PCO's request. The efforts of all field pricing

ing support team members are complementary, therefore, cooperation and communication are essential in order to establish a proper understanding of each member's role.

e. The procedural steps involving contract audit are discussed in later paragraphs of this section. The roles and relationships described in 9-305 also apply in the field pricing support situation.

9-102.2 Applicability of Procurement Procedures

a. FAR/DFARS procedures are cited in this section for convenience and only briefly outlined. Slight variations may occur among DoD components, and procedures applicable to non-DoD agencies may differ. Auditors auditing major or numerous proposals for a particular DoD or non-DoD contracting activity should be familiar with the applicable agency FAR supplement and any special proposal requirements of the procurement office. This information is needed to ensure good support to the PCO, to anticipate procurement needs for contract audit services, and to estimate and monitor workload trends. It is especially important in this regard to know the procurement office's dollar thresholds and related criteria for requesting field audit of proposals (9-102.3).

b. FAR 15.404-2(c)(2), 10 U.S.C 2313(d) and 41 U.S.C. 254d provide that contracting officers are required to contact the cognizant audit office to determine whether an audit of the proposed indirect costs was conducted during the preceding 12 months. Contracting officers are not to request a preaward audit of indirect costs if this would entail duplicative audits. Requests may be made in circumstances where the information available is considered inadequate for determining reasonableness of the proposed indirect costs. (See 1-303)

c. Auditors should verify that contractors are registered in the Central Contractor Registration database for DoD and NASA procurements which contain the clause at DFARS 252.204-7004 for DoD awards or the clause at NASA FAR Supplement 1804.7402 for NASA awards. When the contractor is required by the solicitation to register in the CCR database and the audit discloses the contractor has not complied with that requirement, the auditor should note this in the audit report. To verify if a contractor is registered in CCR the auditor should use the "CCR Database Lookup" function in DMIS.

9-102.3 Applicability of Dollar Thresholds

DFARS 215.404-2(a) recommends that contracting officers consider requesting field pricing support for :

- Fixed-price proposals exceeding the cost or pricing data threshold;
- Cost-type proposals exceeding the cost or pricing data threshold from offerors with significant estimating system deficiencies; or
- Cost-type proposals exceeding \$10 million from offerors without significant estimating deficiencies.

Generally, field pricing support should not be requested for proposals below the thresholds. However, DFARS 215.404-2(a)(ii) permits contracting officers to request an audit of a proposal below the thresholds when a reasonable price can not be determined because of (1) a lack of knowledge of the contractor, or (2) sensitive conditions. When requested to audit a proposal that is below the threshold, the auditor should understand the circumstances driving the request (See 9-103.1d(3)). The auditor should consider if a different level of service could provide adequate field pricing support and should make an appropriate recommendation given the circumstances. The working papers should include documentation on the circumstances and discussions with the requester.

9-103 DCAA Field Pricing Support at the Prime Contract Level

9-103.1 Coordination of the Request-Field Pricing Support

a. In responding to requests for audit services, FAO managers, supervisors, and auditors should keep in mind that the PCO and ACO are our customers. Our aim is to provide timely and responsive audits, audit reports and financial advisory services that meet our customer's needs. This goal can be achieved by establishing open and effective channels of communication that allow for the sharing of information and ideas as the audit progresses. FAR 15.404-2(a)(3) encourages PCOs to team with appropriate field experts and to communicate early in the acquisition process.

b. In particular, requests for field pricing support need to be handled in an expeditious manner. Whenever circumstances permit, FAR 15.404-2(b)(1)(i) encourages the contracting officer and field pricing experts to use the telephone or electronic means to request and transmit pricing information. When reports and information are transmitted electronically, there is normally no need to send an additional copy through surface mail. Proposals should be evaluated for adequacy within seven days after receipt so that corrective action can be taken immediately (see 9-200). In addition, expeditious handling of this matter will enable the auditor to meet the requestor's time constraints. The auditor should seek assistance from the ACO/PCO, if needed, early in this process. The Agency has also developed criteria that can be used to evaluate the adequacy of contract price proposals. The auditor may discuss the checklist with contracting officers and suggest that they use it in the screening process. The form is available on the DCAA Intranet and the APPS (file name ADEQUACY).

c. Locally established working arrangements may expedite handling of relatively routine requests. However, effective field pricing support to the PCO may, in some cases, require individualized cooperative arrangements between the plant representative/ACO and the auditor. Also, some matters may need reconsideration during the course of major field pricing support cases.

d. Additional key matters the auditor may need to coordinate:

(1) Obtaining a copy of the contractor's proposal and applicable portions of the RFP, if not received with the PCO request and not provided directly by the contractor.

(2) Establishing the due date for the audit report, considering existing audit workload, required audit scope, or any other relevant factors. The contract auditor should coordinate due date adjustments with the PCO and the plant representative/ACO. Any audit conflicts involving more than one PCO should be worked out jointly between the auditor and the plant representative/ACO (see 9-103.7).

(3) Obtaining a clear understanding of the requestor's needs and identifying areas of the contractor's proposal for special consideration. Verbal discussions with the PCO and/or ACO should be held before beginning the audit if the auditor does not have a clear understanding of the requestor's needs. Otherwise, communicate information regarding the nature, timing, and extent of planned testing and reporting, including the level of assurance expected to be provided, in the acknowledgment of request letter. The auditor should coordinate with the requestor, upon completion of the risk assessment, to resolve any inconsistencies between the requested audit effort and the scope of audit determined by the auditor's assessed level of risk (see 9-103.3a). If the request is for an audit of something that is immaterial or that could be handled as a request for specific cost information (see 9-107.1), the auditor should discuss this with, and make an appropriate recommendation to, the contracting officer. The final decision regarding the need for a complete examination, an application of agreed-upon procedures, or a request for specific cost information rests with the contracting officer. However, the desire to provide contracting officers with the requested level of service does not mean that the auditor must perform procedures that are clearly not justified. If there is disagreement with the contracting officer after the auditor clearly explains that the risk does not warrant a full examination, Financial Liaison Advisor (FLA) assistance should be requested. The FLAs can provide valuable assistance working with customers to ensure requests for services are accurate, clear, and appropriate for the risk involved. (FLAs are identified in the FLA Locator on the DCAA Intranet site.) If a customer does not have an assigned FLA, the auditor should contact the appropriate Senior FLA. If the FLA's efforts do not result in a consensus regarding the level of service

financial issues affecting the contractor's cost representations. Violations of legal or other regulatory requirements, including instances of noncompliance, will be explained in the audit report.

c. The contract auditor's work normally culminates in an expression of opinion on the acceptability of the contractor's cost representations or financial statements. However, cost representations or financial statements often reflect estimates, approximations, and matters of judgment or opinion, rather than absolute facts. Although other acceptable alternative accounting methods exist within the concept of generally accepted accounting principles, the governing regulations in CAS and in FAR limit the contractor's flexibility in presenting cost representations.

d. A contractor's cost representations may be prepared in accordance with its accounting system, may be based on statistical computations developed as part of the regular accounting system, or from adjunct statistical data; or the contractor may use a formula method for developing costs. The audit report should contain the auditor's opinion as to the acceptability of the methods used by the contractor. An explanation of the methods used should be provided if it is not otherwise evident.

e. The auditor should determine if any material changes have been made in the contractor's accounting practices. Material changes and the reasons for them should be identified, and their effect on the financial representations, both historical and prospective, should be explained. The auditor should also state his or her opinion as to the propriety of the change. When applicable, CAS places some specific limitations on the extent of such changes and requires submission of price adjustment proposals as a result of changes made to previously disclosed or established cost accounting practices.

f. Events that occur after the audit may have a material effect on Government contract costs. Events, such as potential contract overruns, affect Government contracts directly, while other events, such as impending financial instability, affect all Government work. If such events occur before issuance of the audit report, they should be disclosed in the report. If an audit report has already been issued, but the impact on Government contract costs is significant, the auditor should issue a supplemental report.

g. The possibility that isolated errors of omission or commission will go undetected is always present. Therefore, the auditor cannot certify that all of the costs submitted by the contractor are correct. The auditor can only express a professional opinion as to the acceptability of the cost representations.

h. Before expressing an opinion, the auditor should have obtained and reviewed the available facts and performed, to the extent necessary, a searching and analytical review of the contractor's representations and supporting data. When necessary, the auditor should seek technical assistance from the contracting officer in those matters that fall within his or her purview, i.e., industrial engineering, production control, quality assurance, etc. The initial request should be oral, then confirmed in writing. The auditor should refer to and give effect to the technical findings and opinions of others in the audit report; when appropriate, attach a copy of the technical report to the audit report. If the auditor cannot get the necessary technical assistance before completing the audit, the opinion in the report should be qualified and should indicate the areas in which, and the extent to which, a technical evaluation is necessary. If the auditor disagrees with the technical evaluator's recommendations, he or she should attempt to reconcile the differences. If the differences remain unresolved, a copy of the technical report should be attached and an explanation provided in the audit report as to why the recommendations were not used (see D-302).

i. When a contractor's cost representation or financial report is sufficiently complete to permit an audit evaluation, but does not conform to requirements imposed by contracts, agreements, laws, regulations, or administrative procedures (for example, format, timeliness, or certifications), or when certificates or information required from Government personnel have not been received, the audit report should explain the deficiency. The effect that the deficiency may have on the validity of the cost representation should be commented on when possible.

j. A contractor's reports and statements, both financial and operational, should contain the information necessary to form an opinion on contract financial management aspects. The responsibility for providing such information rests with the contractor. However, the auditor should comment if the data provided are insufficient to disclose any matters that may have a material effect upon Government contracts.

(1) Adequate disclosure does not imply or require that every available item of information be furnished. Disclosure should, however, be fair and reasonably complete, but not so complex as to confuse or impede understanding. Information should be reduced to manageable and understandable proportions; without summarizing to such an extent that needed background or relationships are omitted or blurred.

(2) Weight should be given to materiality, which is the relative importance or relevance of an item included in or omitted from financial reports or contract cost statements. Apart from (a) the aggregate \$10,000 materiality criterion for "Unallowable Costs Subject to Penalty" specified by FAR 42.709-5(b) (see 6-609.1f.(7)) and (b) the materiality of defective price findings (see 14-120.1), there are no universal ratios or percentages that can be used as standards of materiality for financial or operational processes or transactions. Materiality should be based on judgment. Six specific indicators of materiality that can be used individually or in combinations are:

- absolute dollar amount;
- ratio of amount of an item to an appropriate base figure;
- length of life of an asset;
- importance of the item to the accomplishment of the mission;
- importance to the maintenance of adequate controls (such as a pattern of small discrepancies); and
- characteristics of the items involved.

(3) The Cost Accounting Standards Board addressed the issue of materiality as it applies to CAS-covered contracts (48 CFR 9903.305). No one criterion was considered necessarily determinative. The criteria are:

- absolute dollar amount;
- proportion of the amount under consideration to contract cost;
- the relationship between a cost item and a cost objective;
- the impact on Government funding;
- the cumulative impact of individually immaterial items; and
- the cost of administrative processing of the price adjustment modification.

(4) Events that occur after the audit may have a material effect on the operations of the contractor or on its financial representations. Such events should be disclosed in a supplemental audit report (see 10-214 and 10-103.3f.).

k. For application of agreed-upon procedures reports, always disclaim an opinion, since an audit is not being performed (10-1009).

10-104 Good Writing Techniques for Effective Audit Reports

a. A very important aspect of performing a quality audit is communicating the results of that audit. Good fieldwork and analysis are wasted if the audit report is not effective in communicating our audit conclusions. Our customer is interested in a clear and concise audit opinion, with supporting data that are easily understood.

b. Natural writing ability is not necessary for effective audit report writing. Effective audit report writing first requires knowledge of good writing techniques, which can be acquired through training and practice. Each FAO's core library contains the third edition of Strunk and White's Elements of Style. The auditor should become familiar with this standard guide to basic rules of usage, composition and style.

c. Effective audit report writing requires selection of efficient ways of collecting the information needed for the report. The Audit Planning and Performance System (APPS) was developed so that the audit planning, documentation of the audit performance and the subsequent audit conclusions are written directly in the electronic working papers. A separate

working paper package is established for each assignment. These working papers should be effectively used to draft the report. This process involves keeping the needs of the reader in mind throughout the audit so that the audit addresses all relevant issues and the auditor records the results in the format used to prepare the report.

10-104.1 Planning the Audit Report

a. Planning to write the report begins with the receipt of a request for audit and/or establishment of the assignment. Planning continues throughout the audit process, from the development of the audit program to the completion of the working papers and then the report itself. The report will not be effective unless the needs of the customer are clearly understood and addressed. If there is any confusion regarding the request or the special needs of the requestor, call the requestor immediately for clarification.

b. Early in the audit process, determine what is required for the audit report. Ensure that the audit program is properly designed so all necessary information is obtained during the course of the audit. Working paper packages should contain lead working papers that are supported by sufficient detail to support the conclusions made. A detailed summary posted to each lead sheet should be used to draft the report. This will save time since the explanatory notes to the audit report are being written at the same time the audit is being performed. The copy and paste software function easily transfers the lead sheet summaries to the draft audit report.

c. Auditor and supervisory time will be saved in the report writing and review phases when interim supervisory reviews are performed. Interim reviews are beneficial since corrections and revisions may be made timely and supporting notes verified for use in the report. This will result in a properly documented working paper package, containing all of the evidence of a well-planned audit, and working paper notes which can effectively be incorporated into the report.

d. Writing an audit report requires original writing combined with CAM suggested wording. Use the suggested paragraphs and carefully revise them to describe the audit situation. "Shell" reports are incorporated in APPS and available on the DCAA Intranet for use as an aid.

10-104.2 Organizing the Audit Report

a. The required structure for the organization of an audit report is prescribed in Chapter 10. Review the parts applicable to the audit area and tailor the audit program to include steps to gather and analyze the data necessary to comply with the guidance.

b. Section 10-200 presents specific requirements for all types of audit reports. The remaining sections of Chapter 10 discuss specific requirements for different types of audit reports. For example, section 10-300 describes price proposal audit reports and audits of parts of a proposal. Section 10-400 describes reports on audits of internal controls and operations audit reports. Keep in mind that 10-200 provides general criteria for all audits, then, where applicable, the remaining sections provide guidance tailored to specific audit areas.

c. The report can be more effective and useful to the reader if a summary of the situation is presented before going into detail. When explaining the audit position, first provide the audit conclusion, then follow with the supporting detail. The reader can then choose whether or not to read all the supporting material. This "inverted-pyramid style" of writing presents the most important point first and follows with supporting detail (see 10-210.6).

10-104.3 Drafting the Audit Report

"Shell" reports contained in the APPS are intended to incorporate all required elements into the report. However, please bear in mind that any report language example (CAM or APPS) may be modified as appropriate. Since the shell reports are for general use, the language must be tailored to reflect each audit. For reports not available in shell format,

ensure that all required elements are included. The general arrangement of the report and the report contents may be found in each section in Chapter 10 at the "Report Format and Contents" subsections. The CAM suggested paragraphs, with revisions when appropriate, may be compared to the Audit Report Quality Review Sheet for CAM compliance. A very important part of the writing process is revision. If possible, prepare the draft report simultaneously as the audit is being performed. This permits ample time for reviews and revisions by the writer and others.

10-104.4 Clarity and Precision in the Audit Report

a. Review the draft report to see if it is complete and balanced. Make sure CAM guidance is followed for the type of audit report being issued. For customer requested assignments, check the request for audit to see if all special items have been addressed. Then determine if the report has the level of detail appropriate under the circumstances. Keep in mind that the report will be read by persons who are not auditors or accountants. Does it read well and make sense to those outside of the auditing profession? Does it read well to readers who may not be familiar with a particular contractor's practices or audit history? Will it prompt the desired action? A good audit report is clear and concise, expresses a well-founded audit opinion, meets the customer's needs, and is in accordance with the CAM guidance and GAGAS.

b. Make the report concise, but provide enough detail for it to be useful. This includes exhibits and supporting schedules -- make sure that they are adequate. Do they provide enough information for a clear and complete explanation of the audit results and recommendations? When determining the amount of detail to include in the report, remember the report is generally written for more than one recipient or customer. Do these customers have the same background? How knowledgeable are the customers about the subject? The report should be written so that the readers will fully understand the entire report, no matter how many words are needed. A good explanatory note to an audit report, for example, would discuss the following:

- the summary of conclusions;
- the basis for the contractor's proposed or claimed amounts;
- the audit evaluation (include a description of procedures used to evaluate the area being described. If qualified, fully describe the effect of the qualification);
- the contractor's reaction (other than proposal audit reports, where judgmental items are usually not discussed with the contractor); and
- the auditor's response if the contractor disagrees with the audit results.

c. Verify the facts and check the calculations. Ensure that amounts described in the results of audit agree with exhibits and that the exhibits agree with the explanatory notes. Technical errors cause confusion for the recipient and weaken a report considerably.

d. If time permits, allow the report to "cool," preferably overnight, so that the draft may be reviewed with a critical eye. If this is not possible, perhaps a peer will agree to review it.

e. Reread the report looking for grammatical and spelling errors. Use the spell-check feature on the word processing software to help. Make sure that all names are spelled correctly. Errors in spelling and grammar also weaken a report.

10-104.5 Responsiveness to the Customer in the Audit Report

When writing the report, focus on the customer's needs. In addition to meeting GAGAS requirements, the report must be useful to the primary report recipient. To accomplish this, focus on the customer. Remember that a report accomplishes nothing unless the reader becomes better informed or is moved to action.

10-104.6 Readability of the Audit Report

a. Shorter words and sentences promote understanding. When writing a sentence, be concise; eliminate unnecessary words. A busy reader will find the report easier to read and to understand. A sentence is wordy when it includes words that add nothing to the meaning of the sentence. For example, compare the following sentences.

Wordy: It is our understanding that the contractor's estimates were prepared by using vendor quotations that are considered outdated.

Better: The contractor based its estimates on outdated vendor quotations.

The Elements of Style, available in the FAO core library, at section II, item 17, lists commonly used expressions that should be eliminated from every sentence. For example,

Wordy: the reason why is that

Concise: because

Vary the sentence length. Break long sentences into shorter ones. The average sentence length should be about 17 to 20 words.

b. Put statements in a positive form.

Negative: The contractor's internal control system of recording labor does not meet certain requirements.

Positive: The contractor's internal controls over labor recording are weak.

c. When possible, write as if speaking. Imagine talking to the reader in a professional situation. Don't try to inflate the report with impressive words. Use ordinary words that the readers easily understand. Use short words in place of long ones whenever possible. Use action words and make writing direct rather than elaborately indirect. Use pronouns if the writing calls for them. For example, "At your request, we limited our audit to" correctly uses three pronouns "your," "we," and "our."

d. Use a variety of punctuation -- beyond the period and the comma -- to control emphasis and to help avoid monotony. Use the dash only when a more common mark of punctuation seems inadequate. For example, "The contractor did not adequately support many key decisions -- such as streamlining the acquisition process and entering production without a research and development phase." The dash is a mark of separation stronger than the comma that sets off material that results from a break in continuity or thought in a sentence. The variety of punctuation provided can help stimulate the reader's imagination, which aids in the delivery of the message.

e. Jargon, a specialized or technical language used by a select group, is difficult for persons outside of that group to understand. Avoid jargon; replace it with plain English. Consider these examples of bureaucratic jargon and the plain English replacements:

Bureaucratic Jargon:	Plain English:
afford an opportunity	let
due to the fact that	because
monetize	give a dollar value
utilize, utilization	use

Choose words and phrases carefully. Use short, simpler words and phrases for easier reading.

(1) Jargon also can be any language which clouds a sentence's meaning by hiding its main subject and verb. Compare the following sentences:

Difficult: Excess starting load costs were allocated by the contractor to the terminated portion of the contract on the basis of an unrealistically low projection of the labor costs which would have been incurred on the terminated units.

Better: Because the labor cost estimate was too low, the contractor allocated too much start-up cost to the terminated contract.

(2) Jargon also occurs when common words take on a special meaning within a profession and create confusion in the minds of those outside. For example, auditors frequently use the verb "monetize," meaning, to them, to determine a monetary value. This usage is inaccurate. "Monetize" actually means (a) to coin into money, or (b) to legalize

as money. It should not appear in an audit report. Search for substitutes, such as "We have calculated the dollar value of the technical recommendations."

(3) Acronyms or abbreviations sometimes cause confusion. If an acronym is used frequently and is commonly understood by the report users, provide the complete words the first time followed by the acronym in parentheses -- for example, total quality management (TQM). Or, reverse the order if the acronym is more familiar than the words. In such case, provide the acronym first, followed by the words it stands for in parentheses -- for example, NASA (National Aeronautics and Space Administration). When in doubt about the familiarity of the acronym or abbreviation to potential readers, don't use it. Redefine unusual acronyms periodically throughout the report. They should be redefined when first needed in each section of the report and possibly every two to three pages.

(4) Some words are used incorrectly in audit reports. "Unsupport" and "unresolve," used as verbs, are prime examples. "Unsupported" and "unresolved," when used as adjectives, are perfectly acceptable.

Correct: The contractor's tooling costs are unsupported.

Incorrect: We unsupported the tooling cost.

(5) For "plain English" words inappropriately used, refer to The Elements of Style, which may be found in the FAO core library. Part IV is devoted to words and expressions commonly misused and includes numerous examples.

10-104.7 The Visual Impact of the Audit Report

a. Visual presentation is an important part of communicating. Use headings to set off main points and "bullets" to highlight several items where one item does not have priority over the other item. For example, a bullet list is effective for listing points because:

- each point is emphasized;
- the items are easier to see; and
- there is more space around each point.

Use a numbered list when the points must be taken in order or when some items are significantly more important than others.

b. Charts, graphs, and tables may be used to summarize voluminous amounts of data in a meaningful and concise manner. They add variety to the report and may easily be developed from available Agency software. Auditors are encouraged to use charts, graphs, and tables where they result in increased clarity and understanding of complex audit findings.

c. The effective use of white space (a term from printing meaning that part of the page that does not have any ink printed on it) can make a report more inviting to the reader. If a paragraph has more than 10 to 15 typed lines, consider dividing it into two paragraphs. Group like ideas together to form separate paragraphs. Highlight extracts from regulations or the contractor's policies by separating and indenting them as a block. If paragraphs or other items are numbered or lettered, ensure that there are at least two paragraphs or items, i.e., there should be a "2" for each "1" and a "b" for each "a."

10-104.8 Active and Passive Voice

a. Using the active voice in writing can improve clarity. Knowing the difference between the active and passive voice requires understanding the grammatical structure of sentences. A complete sentence has a subject and a verb. For example, "The auditor wrote the report" is a complete sentence in the active voice. A sentence is in the active voice when the grammatical subject (the auditor) is doing the action expressed in the verb (wrote). In this sentence, the active voice sounds more natural than passive voice and is easier to understand.

b. The same statement could be expressed in the passive voice: "The report was written by the auditor." In this case, the grammatical subject (the report) has the action of the verb performed on it (was written). A sentence is in the passive voice when the subject receives the action of the verb.

c. Sometimes voice is confused with tense. Voice indicates whether the subject is doing the action (active voice) or is receiving the action (passive voice). Tense indicates time or duration. A sentence in the active voice can be in forms of the past, present, or future tenses -- "The auditor wrote the report;" or "The auditor is writing (or writes) the report;" or "The auditor will write the report." All of these examples are in the active voice but are in different tenses.

d. Bureaucratese, the language of the bureaucracy, often uses the passive voice because it is easier to avoid stating who is doing the action. In the sentence in the passive voice "The report was written," there is no mention of who did the writing. Writing in the active voice forces the writer to state who is doing the action: "The auditor wrote the report." In this sentence, use of the active voice makes the sentence stronger and easier to visualize and understand.

e. Good technical writing often requires use of the passive voice. There is nothing wrong with using the passive voice when the emphasis is on the effect of the action, not the actor. ("Bad debts are questioned," not "The auditor questioned bad debts," or "FAR 31.205-3 mandates the questioning of bad debts.") The passive voice is appropriate when the doer of the action is understood and perhaps not important to what is being said. As a rule, use of the passive voice should be limited to situations in which the doer is:

- unknown;
- unimportant;
- deliberately de-emphasized; or
- obvious to the customer.

These situations are quite common in audit reports and other technical writing.

10-104.9 Misplaced Modifiers and Pronouns

a. A "modifier" is a word (usually an adjective or adverb), a phrase, or a clause that modifies the meaning of another word or phrase. Place modifiers in sentences so they are close to the words they define.

Misplaced: He only found two mistakes. (Because "only" can be either an adjective or an adverb, it can modify either nouns and pronouns (as an adjective) or verbs, other adverbs, and adjectives (as an adverb). As placed in this sentence, it can modify the pronoun "he" and the sentence appears to mean "He did nothing other than finding two mistakes.")

Correct: He found only two mistakes. (Here "only" modifies "found;" we don't know what else he did, but he found no more than two mistakes.)

b. A modifier makes the meaning more specific. When a modifier is too far from the word it modifies, the reader may connect the modifier to some other word. The reader may also be confused when a modifier ambiguously appears to modify two words.

c. Too many modifiers weaken writing. Strings of words or phrases often bury the subject and confuse the reader. The following is an example of a string of words that together modify the last word: "nonrecurring cost recoupment charge internal controls." The first five words say what kind of controls there are, but it is difficult to read. An improved version is "internal controls for recoupment of nonrecurring cost." (This version suffers from "prepositional decay;" the prepositional phrase "for recoupment" is modified by the prepositional phrase "of nonrecurring cost." In technical writing, style must sometimes be sacrificed to clarity.)

d. Similarly, pronouns are often misplaced. Pronouns, similarly to acronyms, are substituted for nouns for brevity and to reduce repetitiveness. A pronoun must agree with its antecedent in person and number (third person singular pronouns must also agree in gender). The antecedent of a pronoun is usually the closest noun preceding the pronoun that agrees with it in person and number. The following sentence illustrates what can happen when too many other possible antecedents come between the intended antecedent and the pronoun: "You hold the hammer while I hold the nail, and when I nod my head, you hit it."

10-104.10 The Requestor's Perspective

a. The tone of the report should be objective, professional, and courteous. Use conversational English, which is a relaxed, professional style. Report writing can be somewhat informal in tone yet remain professional and businesslike. Keep in mind that the goal is to get a favorable reaction. Avoid using accusatory, inflammatory language -- this is likely to cause defensiveness and opposition. In presenting problem areas, emphasize improvements needed.

b. Review the draft from the customer's perspective. Is the report thoroughly responsive to the customer's request? Remember that a report accomplishes nothing unless it is useful to the requestor.

10-104.11 Final Steps

a. Before submitting the report for supervisory approval or for peer review, check again to ensure the report complies with CAM guidance. The draft report should always be cross-referenced to the working papers. This ensures that the audit conclusions are supported and are easily found. A peer reviewer should not rewrite the report in his or her own personal style, but should provide a critical review for content and for good writing techniques, such as those outlined in this section. If a peer reviewer is not available, put the report aside for a day or two, if time allows, then reread the report. If it does not make sense when being reread, it will probably not make sense to the reader either. Another point of view during the review process can help develop a final draft needing little or no revision by the supervisor.

b. If the supervisor requires the report to be modified, ensure that the change is reflected throughout the entire report. If significant changes are made to exhibits and schedules, request the peer reviewer to check both the "carry" of numbers from schedules to text and the mathematical accuracy of the report.

10-200 Section 2 --- Audit Report Format and Contents (General)**10-201 Introduction (Reports-General)**

a. This section discusses DCAA requirements governing audit report content; details the general administrative and format requirements of audit reports; lists and defines the elements of audit reports in their order of appearance in the report; summarizes DCAA policy regarding protection of report information; and provides guidance on audit report distribution. It also explains the circumstances under which supplemental audit reports should be issued and describes the recommended format for these reports.

b. The guidance included in this section is general in nature and applies regardless of the type of audit report being prepared. Specific report preparation requirements for various types of individual audit assignments are discussed in the remaining sections of this chapter. "Shell" reports, which include standard paragraphs required by specific reports, are available on the DCAA Intranet and the APPS.

10-202 Reporting of Audit Results (Reports-General)

To satisfy Government reporting standards (2-400 and 2-600), there must be a written record of the results of each audit. Normally, this requirement is satisfied by issuing an audit report. Certain situations, however, may call for preparation of a "MEMORANDUM FOR RECORD" (refer to DCAAM 5020.1, Correspondence Manual) rather than an audit report. This may be appropriate, for example, upon completion of an individual overhead account audit, which represents only one portion of a final overhead audit report to be issued later, and the individual audit does not find any audit exception, system deficiency, or economy and efficiency findings that need to be reported to contracting officers. Under no circumstances will reports be addressed "to the file" or "for the record" (See 10-206 for addressing requirements).

10-203 Report Administrative Requirements (Reports-General)**10-203.1 Paper**

When reports are printed, use 8 1/2 by 11 inch paper. If wider sheets are needed for tabulations, reduce them to 8 1/2 by 11 inches and print in landscape mode if necessary. The paper should be white and of a grade, weight, and substance as available through normal supply channels for laser printers and for copiers.

10-203.2 Margins

Margins should be uniform; e.g., allow 1 inch for left and right margins and at least 1 inch at the bottom of the page. There should be at least two lines between the last line of typing and the page number.

10-203.3 Typing

Computer equipment and Agency designated word processing software should be used to the extent possible to prepare all portions of the report, including exhibits and schedules.

10-203.4 Paragraphing

a. Other than the "AUDIT REPORT AUTHORIZED BY" section title, which should be bold, placed at the left margin, and followed by a colon, section titles should be bold, upper case and centered in the narrative portion of the report. When a paragraph subtitle is

appropriate, place it on a separate line. Paragraph subtitles should be regular type, upper case, and placed at the left margin (see Figure 10-2-2).

b. The first sentence of main paragraphs should be indented no more than one half of one inch (tab at .5") from the left margin. The subparagraphs within "SIGNIFICANT ISSUES," "QUALIFICATIONS," "EXPLANATORY NOTES," and "RESTRICTIONS" will be lettered or numbered if there are two or more; when there is an "a", there must be a "b", etc. The sequence for paragraph numbering is 1. a (1) (a).

c. Any subparagraphing after a lower case letter in parentheses [(a), (b)] is discouraged. Try to use paragraph captions wherever possible to avoid this.

10-203.5 Upper Case Lettering

The audit report cover sheet (10-205) should include the heading and captions in upper case letters, as shown in Figure 10-2-1. Paragraph titles and subtitles within the report should also be in upper case letters. The "FOR OFFICIAL USE ONLY" footer will also appear in bold upper case letters. Explanatory note captions may be written in upper and lower case letters and underlined.

10-203.6 Date

Express the month, day, and year of the audit report in the order named (for example, December 16, 20XX). The date can be either stamped or typed. The FAO should have a control in place to ensure that reports are dated only after they are signed.

10-203.7 Page Numbering

a. Do not number the cover sheet or place a number on the next (first) page of the report. Begin numbering pages on the second page of the report with the number "2." Consecutively number pages through the report distribution and release restrictions. Numbers should be placed at the bottom center of the page, above the "FOR OFFICIAL USE ONLY" footer. Do not offset page numbers with periods, dashes, or other punctuation. Examples of report numbering are contained in the audit report shells.

b. If DCAA assist audit reports, Government technical reports, or other documents that are individually numbered are included in a report as appendixes, it is necessary to number only the first page of the document. In cases where many appendixes are included in a report, it may be convenient to preface each appendix with a blank sheet indicating the title of the appendix and page number, rather than making any annotations on the particular document.

10-203.8 Numbering Audit Reports

a. The audit report number is the assignment number prefixed by the regional organization code (RORG) of the Branch Office or Resident Office. This is necessary as the Agency MIS reports are sorted at the Branch Office or Resident Office RORG level only. The Suboffice RORG does not appear on Agency MIS reports. The audit report number must be identical to the assignment number set up in the DMIS. No additional alphanumeric characters are to be added to the audit report number. The audit report number will be shown at the top left margin of each page of the report, after the audit report cover sheet. On the cover sheet, the audit report number will be centered under the Agency name at the top of the cover sheet, as shown in Figure 10-2-1.

b. The FAO, at its option, may include the Suboffice RORG and/or a chronological reference number known as a "Chron. No.", as the last item in the "REFERENCES" section of the cover sheet. The Chron. No. should not appear anywhere else in the audit report.

10-203.9 Report Assembly and Reproduction

a. The "original" copy of the signature page of the report must be signed by an auditor with the authority to do so (10-211). See 4-407e(3) for guidance on scanning the signature page into the working paper file.

b. Fastening. Printed reports will be securely fastened at the left margin. Thus, any tabulations or graphs, for example, must be positioned with their headings either at the top or at the left side of the assembled report.

10-203.10 Electronic Distribution of Reports

a. To the maximum extent possible, all written correspondence and audit reports should be transmitted electronically to requestors and customers via e-mail. DCAA e-mail to DoD components will be sent only through Defense Information Systems Agency (DISA) supported communications channels to ".mil" addresses. NASA Headquarters Office of Procurement has also authorized its NASA Centers (generally ".nasa.gov" addresses) to request and receive DCAA audit reports electronically. Procedures for electronic communications with other non-DoD customers should be determined on a case-by-case basis after consultation with the customer and the regional information technology (IT) staff. Transmission of "For Official Use Only" material using private and commercial service providers, such as AOL or CompuServe, is prohibited.

b. It is critical to communicate with customers to determine the version and brand of software they are using. Based on customer requirements, choose the appropriate format and version that provides the best opportunity for the customer's efficient use of the audit report and any accompanying files or attachments. If the customer requires the use of compression technologies, specific arrangements should be made to ensure delivery. The possibility exists that the e-mail will not be delivered to the recipient as many networks strip compressed files from incoming e-mails because of virus concerns. The regional IT staff should be consulted if problems arise while preparing files for transmission or during the electronic transmission.

c. Cover e-mail messages for audit reports should only include administrative-type information. Cover message subjects will include contractor name, customer reference number (if any), and assignment subject (e.g. XYZ Company-DCMA Case No. 05E100005-CAS 410 Noncompliance). Cover messages will also provide information in the body of the e-mail, such as:

- (1) name of document attached,
- (2) audit assignment number for reference purposes (if not already in the filename),
- (3) software used to prepare the report; e.g. Microsoft Word (version),
- (4) comment that the audit report is marked "For Official Use Only,"
- (5) comment regarding the use of password protection of the document to guard against modification,
- (6) if applicable, instructions for opening the compressed file(s),
- (7) if applicable, whether and why an electronic report is incomplete, and
- (8) a cautionary note regarding the intended recipients and use of the e-mail (use the sample provided below).

Example cover message follows:

"Attached is subject audit report [provide file name] which is prepared in [specify the specific version of Microsoft Word]. The attached report is For Official Use Only. While it is password protected from accidental changes, it can be opened as a "read only" document without using the password. However, information within the report can be copied to a new document for analysis purposes.

The report was compressed using *[specify the software used and whether the file was saved as a self-extracting file or not]*. To extract (decompress) the report *[provide specific steps to the user on how to extract the file]*.

The report is incomplete *[provide reasons why (e.g., hard copy forthcoming) the report is incomplete to the customer]*.

If you have difficulty opening the audit report document or have other questions, please contact *[provide points of contact to the customer, including telephone number and e-mail address]*.

IMPORTANT: This e-mail, including all attachments, constitutes Federal Government records and property that is intended only for the use of the individual or entity to which it is addressed. It also may contain information that is privileged, confidential, or otherwise protected from disclosure under applicable law. If the reader of this e-mail transmission is not the intended recipient or the employee or agent responsible for delivering the transmission to the intended recipient, you are hereby notified that any dissemination, distribution, copying or use of this e-mail or its contents is strictly prohibited. If you have received this e-mail in error, please notify the sender by responding to the e-mail and then delete the e-mail immediately."

10-203.11 Citations of Legal Opinions

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 citation must be formally coordinated, through the region, with Headquarters, Policy and Plans Directorate. The Headquarters division responsible for the audit issue will coordinate with our legal advisors and the FAO to ensure that the citation is relevant and properly applied.

10-203.12 Insignificant Amounts/ Elimination of Cents

a. Only significant amounts of questioned costs should be displayed in audit reports. The CAS materiality criteria in 48 CFR 9903.305(a) to (f) should be considered in making this determination. These criteria are: absolute dollar amount; ratio of the amount of an item to an appropriate base figure; relationship between a cost item and cost objective; the impact on Government funding; the cumulative impact of individually immaterial items; and the cost of administrative processing of the audit exception.

b. Cents should not be included in summary report paragraphs, exhibits and schedules. However, they can be used in certain explanatory notes and supporting schedules, such as those relating to direct labor rates or material unit prices.

10-203.13 Protection of Report Information

All DCAA audit reports not containing classified information are "FOR OFFICIAL USE ONLY" and will be marked "FOR OFFICIAL USE ONLY" centered at the bottom of each page of the report. When pages are numbered, (beginning with page number "2") the number

is positioned above the "FOR OFFICIAL USE ONLY" footer. Reports containing classified information will be prepared, classified, marked, and protected in accordance with DCAAM 5205.1, "Information Security Program." To the extent possible, limit classified material included in the report, because audit reports must be classified at the highest security classification contained therein. Also see 10-205.2 if the report pertains to a classified subject.

10.203.14 Report Terminology

a. The report terminology used in this chapter reflects Statement on Standards for Attestation Engagements (SSAE), issued January 2003. However, SSAEs never uses the term "audit" or "auditor." Instead it refers to three types of "evaluations" (examination, review, and application of agreed-upon procedures) and "practitioners." DCAA is covered by Generally Accepted Government Auditing Standards (GAGAS), which incorporates the SSAE for attestation audits (GAGAS chapter 6). However, GAGAS continues to refer to "auditors." For all of the work that DCAA performs, the related fieldwork, and the resulting reports, DCAA will use the term "audit" to generically describe the work. The specific types of audits DCAA auditors perform are examinations, reviews and applications of agreed-upon procedures, and when referring to a specific type of audit, DCAA will use this terminology. In addition, an examination (highest level of assurance) will continue to use the word "audit" in report captions. In general, the work that DCAA auditors perform has not changed; but the report terminology differs under GAGAS and SSAE. Operations audits are an exception because they are performance audits under GAGAS chapters 7 and 8, and are not subject to the SSAE. Refer to 10-403.

b. The difference between an examination, a review and an application of agreed-upon procedures, simply stated, is the level of assurance. For details, refer to Chapter 2. The preferred terms are contained in the Subject, Scope and Results paragraphs in each section in Chapter 10. If the audit is an examination, the report caption is "Subject of Audit," but the related report narrative will state "we examined." Similarly, if the audit is either a review or an application of agreed-upon procedures, the report captions are "Subject of Review" and "Subject of Application of Agreed-Upon Procedures," respectively. The related report narratives will state "we reviewed" or "we applied agreed-upon procedures."

c. Most of the audits DCAA auditors perform are examinations that require a high level of assurance. If the assignment is reduced to a moderate level of assurance, a review may be performed. Attestation standards provide that audits of internal control (10-400) and audits of compliance with laws and regulations (10-600 and 10-800) may not be performed as reviews. However, any assignment may be performed as an application of agreed-upon procedures when the procedures to be performed have been specified by the requestor. Refer to 10-1000 for requirements. Currently, specific guidance has been provided for only one type of review, an incurred cost desk review (10-506).

10-203.15 Spreadsheets

a. An assessment should be made in each case if the contents of a detailed Excel spreadsheet would be useful to the report user. Generally Excel spreadsheets should not be embedded in the audit report. If the contents of a spreadsheet are to be included in a report, they should be pasted into the report as a table as opposed to a spreadsheet. This method of providing information reduces the chance of accidental change, provides only the data the auditor intended to include in the report, and keeps the audit report file size at a minimum to facilitate electronic transmission.

b. In many instances, audit report recipients find the auditor's spreadsheets useful in performing negotiation scenarios, preparing business clearances, etc. Where reports

contain tables generated from spreadsheets that may be useful to the recipient, an offer to provide the spreadsheets should be included in the Results of Audit. Where spreadsheet usage was significant, the auditor may also contact the requestor in advance to determine if the requestor would like the spreadsheets to be provided outside the audit report.

10-203.16 Hyperlinks

Auditors should use electronic linking to enhance report navigation between the Exhibit and explanatory notes. All links not intended for customer use (such as those to working papers) must be removed. "Delete Hyperlinks" can be used within APPS to prepare the final report. This tool can be used comprehensively or individually.

10-204 Report Format (Reports-General)

a. Major examination or review report components are listed below in the sequence in which they generally appear. They are discussed in detail in the referenced paragraphs (see 10-1000 for the components of a report on an application of agreed-upon procedures). Those components highlighted with an asterisk should appear in every DCAA audit report regardless of type to satisfy minimum professional standards. Other elements may or may not be included in a particular report depending on the type of audit performed or other circumstances. For example, "Qualifications" is not identified with an asterisk but becomes a mandatory report requirement if existing conditions require its use. Elements pertaining only to certain report types are indicated. Refer to the remaining sections of Chapter 10 for additional guidance on audit report preparation for specific types of audit assignments. Requirements for reports on applications of agreed-upon procedures are covered in 10-1000.

[Audit] Report Cover Sheet (10-205)*

Addressee (10-206)*

Subject (10-207)*

Reference (10-208)

Contents (10-209)*

Report Narrative (10-210)*

Subject of Audit (10-210.1)*

Executive Summary (10-210.2)

Scope of Audit (10-210.3)*

Qualifications (10-210.4)

Statement of Changes (CAS reports only - see 10-803b.)**

Results of Audit (10-210.5)*

Opinion

Exhibits and Schedules (10-210.5b.)

Unsatisfactory Conditions and/or Other Audit Recommendations (4-800)

Additional Remarks (10-210.5e.)

Statement of Condition and Recommendations (see 10-409 and 10-803b.)**

Cost Impact only - see 10-803b.)**

Contractor Organization and Systems
(10-210.7)

Status of Corrective Action Taken on Prior Recommendations (e.g., System Reports)

DCAA Personnel and Report Authorization (10-211)*

Audit Report Distribution and Restrictions (10-212)*

Appendixes (10-213)

*Required in every report regardless of type. Note the modified report language for reviews (10-506) and application of agreed-upon procedures (10-1000).

**Replaces Exhibits and Schedules for operations, internal control, or CAS reports.

b. If an audit is stopped before it is completed, auditors should write a memorandum for the record that summarizes the results of the work and explains why the audit was terminated. The auditor should also communicate the reasons for termination to the requestor. The communication should preferably be in writing.

10-205 Cover Sheets

10-205.1 General

a. An Agency cover sheet bearing the DoD and DCAA seals is required for the original of every report, including reports transmitted electronically. The general format is shown in Figure 10-2-1. Audit report restrictions relative to (1) Freedom of Information Act requests, (2) confidentiality of contractor information in the report, (3) restriction on release of the report outside the Department of Defense, and (4) release of subcontract audit reports to the higher-tier contractor, are referenced on the cover sheet ("REPORT RELEASE RESTRICTIONS" and "CONTENTS") and provided in detail immediately following the signature page of the report. See 10-212, Report Distribution and Restrictions.

b. Include the report heading (Agency name and report number), date, captions and descriptive information relative to the audit on the cover sheet as presented in Figure 10-2-1. The report date must be the date the report is signed and forwarded to the requestor or other addressee; it should not be incorporated as a field date, since a permanent record of the issue date is required. The FAO may also include its e-mail address in the "PREPARED BY" section as shown in Figure 10-2-1.

10-205.2 Cover Sheets for Reports on Classified Subjects

a. If the report contains a security classification (see 10-203.13), the classification marking must replace "For Official Use Only" on the report cover. This should be done by deleting "FOR OFFICIAL USE ONLY" and inserting the appropriate security classification on both the top and bottom of the audit report cover. If a stamp for the appropriate classification is not available, classification markings should be made in letters conspicuously larger than the size of the print of the report.

b. If an audit report pertains to a proposal or a contract that is classified or includes classified elements, and the auditor is unable to determine the appropriate security classification of the report, a special "warning" label (DCAA label 5) must be affixed (see DCAAM 5205.1, DCAA Information Security Program Manual, Section 1-400.b). The label is placed above, but not covering, the "FOR OFFICIAL USE ONLY" legend on the audit report cover, and the report must be sent via registered mail. Contact the regional security officer for instructions prior to release of the report. Regional offices should consult with the Headquarters security officer if they have questions on this procedure.

10-206 Addressees (Reports-General)

10-206.1 Prime Contract Report Addressees

a. It is DCAA policy that audit reports at the prime contract level be addressed to a contracting officer unless it is clear that another acquisition official will be responsible for resolving the audit findings and recommendations. For example, reports on price proposals (9-100) would be addressed to the procuring contracting officer (PCO) unless a plant representative/administrative contracting officer (ACO) has been delegated procurement authority to execute the particular contract action. This policy results in audit findings being directed to the individuals responsible for resolutions and facilitates timely contracting officer action.

b. Even if the audit report does not contain findings requiring resolution, the report addressee should normally be the cognizant contracting officer. Under no circumstances will reports be addressed "To the File" or "For the Record."

c. A number of non-DoD agencies make requests for audits through their Office of Inspector General, which may be responsible for arranging audits for many procurement offices. The assigned number or other assignment identifier contained in the audit requests is their primary means of identifying these assignments. To help these offices control their assignments and expedite transmittal of reports to responsible officials, non-DoD agency assignment numbers, or other assignment identifiers contained in requests for audit will be included on the cover sheet reference line and within the first paragraph of the "Subject of Audit" section for reports issued to these agencies. Other non-DoD reporting requirements appear in 15-100.

d. Audit reports in support of team system evaluations led by contract administration organizations, such as the Contractor Purchasing System Review (5-1302) or the Contractor Insurance/Pension Review (5-1303), should be addressed to the designated team captain. Reports on should-cost team reviews (9-1300) will be addressed to the PCO. Audit reports on Earned Value Management System (EVMS) initial compliance audits (11-202.8) will be addressed to the review team chief; and reports on EVMS surveillance audits (11-203.5) will be addressed to the principal cognizant ACO. Reports required to support an investigation will be addressed to the requestor.

10-206.2 Subcontract and Intracompany Report Addressees

Most FAO audit reports on intracompany and subcontract matters will also be addressed in accordance with 10-206.1. In certain audit areas, however, such as postaward audits of cost or pricing data (10-600), procurement needs may be better served if the auditor's report from the other company segment or subcontractor level is addressed to the contract auditor at the prime contract level. The recipient auditor will then incorporate the findings and recommendations into a single audit report for action by the responsible contracting officer. Appropriate variations in addressing and distribution of intracompany and subcontract reports will be covered in later sections of this chapter (see 10-303.2, 10-605.2, and 10-708b.).

10-206.3 Form of Address

As a matter of form, audit reports are not normally addressed to an individual by name but to the title of the position. However, if the report is for an office with several contracting officers, the address block should identify the individual in some appropriate manner. This may be done by placing the ACO/PCO's room number, "desk code," "mail stop," or name in parentheses following the contracting officer designation. For example, report addresses may begin: "Procuring Contracting Officer (Code 03D-1)" or "Administrative Contracting Officer (Ms. Mary Z. Brown)."

10-206.4 "THRU" Addressing

When required to route the original report through an intermediate action office other than the addressee's office, use "THRU" addressing. For example, if a report on an audit of a price proposal is addressed to a PCO (other than the plant representative/ACO acting as a PCO) but is to be routed thru the ACO, the "PREPARED FOR" element will be followed by a "THRU" element, as illustrated in Figure 10-2-1. This is generally the case when the ACO is also participating in the field pricing audit of a contractor's submission by providing a price analysis or technical evaluation.

10-206.5 Attention Lines

It is acceptable to use a separate "Attention" line, which may be placed either under the addressee's name or under the office name of the "PREPARED FOR" and/or "THRU" address block when the addressee has requested the FAO to route the report

directly to a particular organizational section or individual within the addressee's office. Do not use an "Attention" line to identify the contracting officer to whom the report is addressed (see 10-206.3).

10-207 Subject Line (Reports-General)

The "SUBJECT" line shown on the report cover sheet should provide a brief description of the audit performed (e.g., Report on Audit of Proposal for Initial Pricing, Report on Audit of Labor Costs, Report on Postaward Audit of Cost or Pricing Data, etc.). Refer to Figure 10-2-1 for an example of the "SUBJECT" line.

10-208 References Section (Reports-General)

a. A "REFERENCES" section should be included immediately after the "SUBJECT" line on the cover sheet. This "REFERENCES" line will identify the audit request, if applicable, including specific reference to any case numbers or assignment identifiers contained in the audit request. This reference line should also be used in subcontract assist audit reports to assist the prime contract auditor in identifying the contract to which the assist audit relates. If a Suboffice RORG or Chron. No. is referenced, it should be the last item which appears in "REFERENCES." If this is a self initiated assignment, the "REFERENCES" section is not mandatory.

b. The auditor should include both the PCO and the ACO case numbers or identifiers if known. In many instances, especially when non-DoD inspector general offices arrange audits for their agencies, the assignment identifier included in the request is the primary means of tracking these assignments. In addition, include a line for "Relevant Dates." This line will indicate what page number the reader should refer to for information used to compute elapsed days, as well as requested due dates and extensions. This information should be described in the "DCAA Personnel and Report Authorization" section of the report.

10-209 Table of Contents (Reports-General)

a. The table of contents will be located on the cover sheet for all audit reports. The "CONTENTS" section should be simple and uncluttered, as illustrated in Figure 10-2-1. Exhibits and schedules should not be listed individually in the "CONTENTS." Instead, the reader will be able to find references to exhibits and schedules by reading listed sections of the report, such as "Results of Audit."

b. Appendixes. If there is only one appendix to the report, show the title and page number in the "CONTENTS." If there are multiple appendixes, use the term "Appendixes" in the "CONTENTS" and show the page number for the first appendix in lieu of listing each appendix.

c. Internal Hyperlinks. The DCAA APPS provides links from the table of contents (TOC) to the applicable sections of the report to allow the recipient to quickly navigate to specific areas of interest. These links are dynamic and should be maintained in the final version of the signed report. Immediately prior to transmission of the signed report to the recipient, the TOC hyperlinks should be updated to ensure the page numbers are correct.

10-210 Report Narrative (Reports-General)

All reports must have a narrative body that includes comments on the subject and scope of the audit, any limitations on the scope of audit performed (if applicable), and a detailed description of the audit results. The contents of each of the report paragraphs are discussed below. The remaining sections of this chapter expand on the content of each of

the narrative paragraphs as they apply to particular types of reports, such as price proposals, cost accounting standards, postawards, etc.

10-210.1 Subject of Audit

a. If the audit is an attestation, begin this section by identifying the contractor assertion or the subject matter on which the report expresses a conclusion and the nature of the engagement (examination, review, application of agreed-upon procedures). Ordinarily the audit expresses an opinion on the assertion (e.g., a contractor submission, disclosure statement); however, an internal control audit expresses an opinion on a subject matter (see 10-400). The purpose and objectives of an attestation audit always includes expressing a conclusion on the reliability of the contractor's assertion or a contractor's compliance with specific criteria relating to a subject matter. If the evaluation is a systems audit, identify the subject matter (i.e., the system being audited) and fully describe the purpose of the audit.

b. Depending on the nature of the audit, information should be included regarding the time period covered by the audit. This information is mandatory for audits of CAS compliance or internal controls, and may be included on other audits, along with such data as date, dollar value, and type of contractor submission, period of performance of the proposed effort, and contract data such as contract type and incentive provisions. Audit reports on price proposals should also include statements about additional cost or pricing data submissions.

(1) An example of a statement that could be included in a report on a price proposal examination follows:

"As requested by [insert requestor's name] on [insert date of request], we examined [insert contractor's name]'s [insert date of proposal] proposal submitted in response to [insert RFP or solicitation number] to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The [insert total price proposed including profit or fee, if any] proposal is for [insert description of service or product to be provided]. The contractor proposed a performance period of [insert inclusive dates of contract performance]."

The proposal and related cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

(2) If the auditor is disclaiming an opinion in an examination report due to an inability to obtain sufficient competent evidential matter because of a scope limitation, the Subject of Audit section's standard paragraph should be changed. The first sentence should state "we were requested to examine" (if a request was received) or "we attempted to examine" (if self-initiated) rather than "we examined" since, because of the scope limitation, the auditor was not able to perform an examination in accordance with generally accepted government auditing standards. In addition, the last sentence "Our responsibility is to express an opinion on the proposal based on our examination" should be deleted due to the scope limitation. The following is an example of a Subject of Audit paragraph for a price proposal examination to be used in a report with a disclaimer of opinion for which an audit request was received:

"We were requested by [insert requestor's name] on [insert date of request], to examine [insert contractor's name]'s [insert type of proposal] proposal submitted in response to [insert RFP or solicitation number] to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The [insert total price including profit or fee, if any] proposal is for [insert description of service or product to be provided]. The contractor proposed a per-

formance period of *[insert inclusive dates of contract performance]*. The proposal and related cost or pricing data are the responsibility of the contractor."

(3) The SSAE treats the word "opinion" as reserved to examinations. AT 101.68 states, "When attestation risk has been restricted only to a moderate level (*a review*), the conclusion should be expressed in the form of negative assurance." The pro forma review reports appearing at AT Section 101, Appendix B, exclude the "responsibility" sentence. Since DCAA retains responsibility for the content of its reports, a statement that might be included in a report on a review (see 2-103c(2)), such as a desk review of a low-risk indirect cost submission (see 6-104.5), could read as follows:

"We reviewed the *[insert contractor's name]*'s *[insert date of proposal]* certified final indirect cost proposal for reimbursement of FY 20XX incurred costs. The purpose of the review was to establish indirect cost rates for the period. The proposed rates apply primarily to the flexibly-priced contracts listed in Exhibit __, page __. A copy of *[insert contractor's name]*'s Certificate of Final Indirect Costs, dated *[insert date of certificate]*, is included as Appendix 1 to the report (see page __).

The proposal is the responsibility of the contractor. Our responsibility is to report our conclusions on the proposal based on our review."

(4) If the evaluation is an attestation engagement and was limited to specific functions or activities, if particular work was or was not performed, or if special aspects were considered in performing the evaluation, perhaps at the request of the contracting officer, the Subject paragraph should also include appropriate special comments. For example:

(a) "At your request, we limited our evaluation to the application of direct labor and indirect expense rates."

(b) "At your request, we limited our evaluation to a determination that the contractor's proposed labor rates comply with wage board determined prevailing rates for the locality."

(5) An example of a statement that might be included in a report on an operations audit follows:

"As part of our comprehensive audit of the *[insert contractor's name]*, we evaluated the contractor's plant maintenance function, which is responsible for the maintenance and repair of equipment and buildings at the Boston facility. We performed the audit to evaluate the effectiveness of the contractor's policies and practices in assuring that maintenance tasks are carried out in a timely, efficient, and economical manner. The audit was conducted from *[start date, month, year]* through *[field work complete date, month, year]* and covered contractor operations for the fiscal year ended *[date]*."

Note that, unlike examples (1) and (4), an operations audit is not an attestation. It is a performance audit subject to the requirements of GAGAS chapters 7 and 8.

10-210.2 Executive Summary

This section is intended to give the reader a brief overview of the audit findings. It should briefly describe the audit recommendations and the significant issues supporting the opinion. The Executive Summary should rarely exceed one page for any audit. This section can be

omitted in reports where the Results of Audit sufficiently summarizes the audit findings. Examples where the Executive Summary may be omitted include contract audit closing statements and reports with no audit findings. An example of an Executive Summary is shown in Figure 10-2-2.

10-210.3 Scope of Audit

a. Introduce the scope of audit section with a statement, which should be modified to fit the evaluation being performed. The italicized portion(s) of the example scope statement provide(s) either guidance or alternative language. Additional guidance is provided in chapter 10 subsections, tailor the scope statement as appropriate, e. g., use the guidance in 10-400 when reporting on an internal control examination or an operations audit.

An example of the initial scope paragraph to be used in an examination follows:

"Except for the qualifications discussed below, [omit if the report is not rendering a qualified opinion and there is no "Qualifications" section within the "Scope" paragraph], we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records examined are free of material misstatement. An examination includes:

- *evaluating the contractor's internal controls, assessing control risk and determining the extent of audit testing needed based on the control risk assessment;*
- *examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;*
- *assessing the accounting principles used and significant estimates made by the contractor;*
- *evaluating the overall data and records presentation; and*
- *determining the need for technical specialist assistance [and quantifying the results of a Government technical evaluation]."*

b. If the auditor is disclaiming an opinion in a report due to an inability to obtain sufficient competent evidential matter because of a scope limitation, the title of the Scope of Audit section should be changed to Scope Restrictions. In addition, the section must omit the statement "we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that..." Instead, the auditor should briefly state all the substantive reasons for the disclaimer in the Scope Restrictions section. If necessary, details regarding the reasons for the disclaimer may be included in an appendix. In this case, the Scope Restrictions section should properly reference the appendix. The auditor should not state here that the scope of the examination was not sufficient to warrant the expression of an opinion. That statement is more properly included in the actual disclaimer paragraph. The auditor should not identify the procedures that were performed nor include the paragraph describing the characteristics of an examination; to do so may tend to overshadow the disclaimer. The auditor should also disclose any other reservations he or she has regarding presentation in accordance with Government regulations. The following is an example of a Scope Restrictions paragraph with a scope limitation imposed by the requestor resulting in a report with a disclaimer of opinion:

"Due to procurement-imposed time constraints, we were not able to obtain sufficient competent evidential matter on which to base an opinion on the (subject matter, e.g., proposal as a whole or the parts of a proposal to be evaluated). The time that was provided for performance of the audit did not allow us to apply auditing procedures to satisfy ourselves as to the acceptability of the contractor's (subject matter)."

The following is an example of a "Scope Restrictions" paragraph with scope limitations due to uncertainties resulting in a financial capability report with a disclaimer of opinion:

"There are significant uncertainties related to the contractor's July 15, 20XX filing of a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code. These uncertainties include, but are not limited to, the future actions of the Official Committee of Unsecured Creditors, the outcome of potential bidders for the contractor's assets, the resolution of ongoing investigations and the Bankruptcy Court's own actions relating to its approval of the disclosure statement and confirmation of the plan of reorganization. The significance of the uncertainties precludes us from expressing an opinion on whether the contractor has adequate financial resources to perform Government contracts in the current and near-term (up to a year)."

c. The scope paragraph of a review should include the following statements, modified or expanded as appropriate:

"Based on an initial assessment of low risk, we performed a limited review sufficient to confirm that there is no readily available information that would warrant a comprehensive examination. We conducted our review in accordance with generally accepted government auditing standards. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on [*subject matter*]. Accordingly, we do not express an opinion."

(See 10-506.2b. for an example of the scope paragraph of an incurred cost desk review; see 10-1007 for the format of the scope paragraph of an application of agreed-upon procedures report.)

d. The next scope paragraph should identify the established or stated criteria used to evaluate the proposal, submission, or system. For example, reports on audits of revised disclosure statements will state that the requirements of FAR and the applicable cost accounting standards were used as criteria in ascertaining the adequacy and compliance of the contractor's revision. Reports on postaward audits may indicate that the criteria used to evaluate the cost or pricing data were DoD's implementation of the law contained in FAR Subpart 15.4 and pertinent provisions of the contract. In a system report, summarize the areas that were evaluated. The following statement may be used, modified for DFARS and CAS applicability, as appropriate:

"We evaluated the [*indicate proposed costs, type of submission, or system reviewed*] using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS) [*for non-DoD agencies, identify specific agency supplement - see 9-102.2 and 15-102.3*]; and
- Cost Accounting Standards (CAS)."

e. The scope statement should be modified depending on contractor CAS coverage. The following type statement should be included when the small business exemption applies:

"The contractor claims exemption under 48 CFR 9903.201-1(b)(3) from the practices required by the Cost Accounting Standards Board rules and regulations because it considers itself a small business concern."

f. The last paragraph of the scope statement should provide information on how the contractor's significant internal control system(s) affected the scope of audit. However,

see 10-400 when reporting on system audits. In addition, provide a statement, which informs the reader that the audit provides a reasonable basis for the audit opinion, e.g. "We believe that our examination provides a reasonable basis for our opinion."

(1) Summarize those accounting and management (business) systems that provide for compliance with laws and regulations for the audit area being evaluated. Generally, a reference to the status of the accounting and/or estimating systems (when applicable) would be sufficient. However, the status of other internal control systems should be reported if audits have disclosed deficiencies that directly impact the scope of the current audit. Include information such as:

- Opinion on the system (e.g., adequate, inadequate in part, or inadequate).
- Summary of outstanding deficiencies affecting the audit scope.
- Impact of the assessment of control risk on the audit scope.

As appropriate, refer to the Contractor Organization and Systems section for additional information on the systems. An example of this paragraph when the accounting system is adequate and the estimating system is inadequate follows:

"We consider [Contractor name]'s overall accounting system to be adequate. We currently consider the estimating system to be inadequate in part (refer to the Contractor Organization and System section). The contractor does not provide cost analysis on subcontractor price proposals to the Government prior to agreement on contract price. Our audit scope reflects our assessment of control risk and includes expanded testing of proposed subcontract costs to provide a reasonable basis for our opinion."

(2) At smaller contractors that do not have independent checks of compliance with policies and procedures (i.e., internal control) or where it is not beneficial to evaluate the internal controls to serve as a basis for reducing control risk (and related audit scope), the scope of audit should summarize this information. An example of this type of paragraph follows:

"We have not specifically examined [Contractor name]'s internal controls. *[If the contractor is a small business add the following sentence. The contractor is a small business with limited resources to be applied to compliance procedures and testing.]* The scope of our examination reflects this assessment of control risk and includes those tests of compliance with applicable laws and regulations that we believe provide a reasonable basis for our opinion."

g. See 10-305.3 for example scope paragraphs for reports on parts of a proposal. See 10-1007 for scope paragraphs for application of agreed-upon procedures reports.

h. If a Government technical evaluation was performed in conjunction with the audit, the auditor will normally incorporate the technical report recommendations into the audit conclusions.

10-210.4 Qualifications

a. The purpose of this subheading within the scope of audit section is to disclose any circumstances which necessitate a qualified opinion. Circumstances having a significant effect on the conduct, scope, or results of the audit should be clearly identified if the conditions result in a qualified opinion in relation to the stated purpose and scope of the audit. In such case, both the "scope" and "results" paragraphs should specifically refer to this paragraph.

b. A qualified opinion states that, *except for* the effects of the matter to which the qualification relates, the subject matter of the assertion is in compliance with the established criteria (e.g., FAR/DFARS). A qualified opinion is expressed when:

(1) there is a lack of sufficient competent evidential matter or there are restrictions in the scope of the examination that have led the auditor to conclude that he or she can-

not express an unqualified opinion and the auditor has concluded not to disclaim an opinion; and/or

(2) the auditor believes, on the basis of the audit, that the subject matter under audit contains a departure from the established criteria, the effect of which is material, and the auditor has concluded not to express an adverse opinion.

c. Restrictions on the scope of audit whether imposed by the requestor, the contractor, or by circumstances may require the auditor to qualify or disclaim an opinion. The decision to qualify or disclaim an opinion because of a scope limitation depends on an assessment of the importance of the omitted procedure(s) to the auditor's ability to form an opinion on the subject matter under audit. This assessment will be affected by the nature and magnitude of the potential effects of the procedures being considered and by their significance to the subject matter under audit. When restrictions that significantly limit the scope of the audit are imposed by the contractor or the requestor, ordinarily the auditor should disclaim an opinion (see 10-210.5d). However, scope limitations due to contractors' failure to make all pertinent records available to the auditor when the records pertain to the representations, claims, or proposals under audit would lead to reports that contain qualified or adverse opinions (see 1-504.1c. and 1-504.6).

d. The Qualifications paragraph should include only circumstances that result in a qualified opinion (see also 10-304.4). Examples of items that may be presented in this paragraph include, but are not limited to qualifications which arise from:

- contractor deficiencies, such as lack of access to or inadequate contractor records and systems;
- external impediments such as time limitations on the scope of audit, or nonreceipt of a required Government report of technical evaluation or assist audit report; or
- contractor failure to comply with formal regulatory requirements, such as FAR and CAS noncompliances where cost impacts could not be reasonably determined.

e. The nature and potential impact of each circumstance and any steps taken by the auditor to overcome or mitigate the problem should be briefly stated. Also explain further action the auditor plans to take after report issuance, if applicable. Keep this paragraph brief and include a reference to the report section and page number that contains a detailed discussion of the item involved.

f. If a required Government technical report was requested and is not received, indicate the reason for nonreceipt and a brief comment on the follow-up action taken to obtain the report from the organization involved. State the specific areas in which technical review is required to conclude the audit. Also recommend that the auditor be given an opportunity to review the results of the technical evaluation, determine its impact on the scope of audit and its overall conclusions, and provide a supplemental report incorporating such evaluation.

g. If the auditor receives a technical report but does not agree with its recommendations, he or she will attempt to reconcile any disagreements with the specialist who prepared the report and/or with the specialist's supervisor. If necessary, assistance to resolve the differences will be solicited from the contracting officer. If the auditor is unable to resolve the differences, he or she should not utilize the technical report in developing the audit opinion or in determining the amount of the questioned costs. In such cases, however, the technical report will be attached to the audit report as an appendix, and the report will include an explanation of the reason the auditor did not rely on the recommendations included in the technical report. The circumstances should be adequately described and the related audit conclusion appropriately qualified.

h. Auditors should be aware that FAR 15.404-2(d) requires that contracting officers be notified in writing when cost or pricing data provided are so deficient as to preclude a satisfactory evaluation or when we encounter denial of access to data or records essential to performance of a satisfactory evaluation. Written confirmation should be accomplished early on in the evaluation and include a description of the deficient or denied data or records; explanation why the denied data or records are needed; explanation of documentation or contractor action needed to correct deficient cost or

pricing data; the amount of proposed cost considered unsupported because of the deficient data or the questioned costs resulting from denial of access to records; and the action taken by DCAA to obtain adequate cost or pricing data.

i. If the auditor encounters scope limitations and FAR/CAS deficiencies resulting in the subject matter of an assertion not being presented in all material respects in accordance with the established criteria (adverse opinion), the limitations should be discussed in the Scope of Audit section (see 10-210.3b); however, they should not be referred as to "qualifications." The "except for" language should not be used when an adverse or disclaimer of opinion is rendered.

j. Where the auditor has assessed control risk at maximum; does not perform work sufficient to reduce audit risk to an acceptable level; and the data relied on during an audit is highly dependent on computerized information systems (see 5-111.1d), qualify the report, as exemplified below:

"To achieve the planned audit objectives [*or, planned objectives for the ___ audit*], we relied extensively on information processed through the contractor's computerized systems [*or, name specific system(s)*]. We did not perform sufficient audit procedures to determine with reasonable assurance the reliability of the computer-processed information. Therefore, our audit results [*pertaining to ___*] are qualified to the extent that they could be significantly impacted by the performance of such procedures."

10-210.5 Results of Audit

a. Depending upon the type of the evaluation, this section should provide the complete details regarding the auditor's opinion (refer to 10-210.4 for a qualified opinion), results of audit, or findings of procedures, conclusions, recommendations, and additional comments including the contractor's reaction to the report findings.

b. The Results section should begin with the phrase, "In our opinion. . ." if an examination was performed. If external factors restrict or limit the scope resulting in a scope qualification, modify the phrase as follows. "In our opinion, except for the (*describe the qualification and the potential impact on the results.*). . ." Do not use the term "opinion" in referring to the results of a review; instead, begin this section with the phrase, "Based on our review. . ." This section should contain exhibits and supporting schedules necessary for a clear and complete presentation of the evaluation results and recommendations. The words "exhibit" and "schedule" should be written entirely in upper case letters when they are used as titles. See 10-210.6 for a discussion of explanatory notes.

c. In audits of proposed or historical cost, the Results of Audit section should begin with a single tabulation that quantifies the audit findings. If further quantification is necessary, designate principal tabulations "exhibits" and identify them by capital letters in consecutive order; e.g., EXHIBIT A, EXHIBIT B, etc. Additional tabulations needed to explain any of the items in the principal exhibits will be designated "schedules." The content of the exhibits and schedules will vary depending on the type of audit report being prepared. Where there are findings in audits dealing with historical cost, the auditor makes a "recommendation." For findings in audits dealing with prospective costs (e.g., forward pricing proposals), the auditor does not "recommend" but may provide a "Difference" column which is intended for the use of the contracting officer in preparing a negotiation position (see 10-304.9). Review the appropriate section of this chapter to identify any specific requirements for the type of audit report you are preparing.

d. Disclaimer of Opinion. A disclaimer of opinion states that the auditor does not express an opinion on the subject matter under audit. A disclaimer is appropriate when the auditor has not performed an audit sufficient in scope to enable him or her to form an opinion on whether the subject matter is in accordance with the stated criteria. See 10-210.4 for factors to consider in deciding whether to qualify or disclaim the audit

report opinion. When the auditor is disclaiming an opinion in an examination report, the first paragraph of the standard Results of Audit section should be modified as follows:

"Due to (*state limitations in scope*) discussed in the Scope Restrictions' section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the [*identify the subject matter*] is in all material respects, based on [*identify criteria*] as discussed with [*the contracting officer or representative*] by [*auditor*] of our office on [*date*] and as confirmed in our [*memorandum/letter*] to you dated [*date*]."

An example of a disclaimer of opinion on a pricing proposal is as follows:

"Due to the procurement-imposed time constraints discussed in the Scope Restrictions section, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on whether the contractor's proposal is in all material respects, based on [*identify criteria, such as FAR, DFARS, other Agency supplement regulations, and CAS*] and, therefore, acceptable as a basis for negotiation of a fair and reasonable price as discussed with [*the contracting officer or representative*] by [*auditor*] of our office on [*date*] and as confirmed in our memorandum to you dated [*date*]."

e. Additional Remarks. Conclude the Results section of the report narrative with the following comments, as appropriate:

(1) Exit Conference

(a) In reports on all evaluations, state the date held and the name and title of the contractor's designated representative with whom the exit conference was held (see 4-304). If an exit conference was not held, the report should explain the circumstances.

(b) Summarize in this section the contractor's reaction to factual differences, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings. Detailed comments on the contractor's reaction to the report findings will be included in the explanatory notes.

(c) If the engagement is an evaluation other than those listed in 10-212.2c, include the following statement:

"We provided a draft copy of [*the Report*] or [*the Results of Audit*] or [*the Statement of Condition and Recommendation*] and/or [*Other (describe)*] to the contractor's representative at the exit conference."

(d) When a contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the audit report. Include the following statement:

"The complete text of the contractor's response appears as Appendix [X]."

(2) Other Additional Remarks

(a) If information in the report was provided to the contracting officer in advance by telephone, make a confirming statement here identifying the information.

(b) Mention any subsequent or supplemental reports to be issued pertaining to unresolved or qualified costs, if applicable. In most cases, inclusion of a report qualification that arises from an external impediment (see 10-210.4d) should be followed up with a comment regarding the intent to supplement the report (see 10-214.1 for a listing of circumstances when a supplemental report should be issued).

(c) In system audits, express appreciation for the contractor's support and cooperation extended during the audit, if appropriate.

(d) If audit effort was performed more efficiently because of self-governance activities (including coordinated audits), express appreciation for the contractor's cooperation and support. Following is an example of such a paragraph:

"We wish to express our appreciation for the cooperation extended by [insert contractor's name]'s internal audit department during our audit. The coordination of our audit effort with that of the internal auditors enabled us to complete our audit of relocation costs more efficiently."

(e) If a Government technical evaluation was performed in conjunction with the audit, the auditor will normally incorporate the technical report recommendations into the audit conclusions (note the exception discussed under 10-210.4). In such cases the audit report should include an additional statement, such as the following:

"The audit conclusions incorporate the dollar effect of the recommendations in the related Government report of technical evaluation performed by [insert name of activity providing the review]. The technical report is enclosed as Appendix [X]."

(f) The availability of the auditor to furnish additional services including attendance at negotiations will be presumed in routine audits. If an offer of special assistance or where auditor attendance at the negotiation conference is considered critical, insert a note to this effect. Since this is likely to be related to significant issues, the note would also be included at the conclusion of the Executive Summary. An illustration of the note is shown below:

"Because the contractor contested certain significant issues raised in our recommendations (see Appendix [X]), we recommend that you invite a DCAA representative to attend the negotiation conference."

10-210.6 Explanatory Notes

a. Explanatory notes may be omitted in audit reports where there are no findings and the requester has indicated that the information describing the basis of the cost and the audit evaluation would not be useful at negotiations. See 10-210.5b and c for a discussion on exhibits and schedules in the results of audit.

b. In reports that question contractor proposed costs, explanatory notes should contain detailed information such that the contracting officer is able to understand clearly the basis for each element of cost, how the cost was evaluated, and the conclusions made on the basis of that evaluation. Explanatory notes should be prepared for each significant cost element. When the contractor agrees with the audit findings, the explanatory note(s) may be abbreviated. When explanatory notes are redundant, a common note may be used, if the results can be presented more efficiently. For explanatory notes that deal with proposed costs, i.e., forward pricing, terminations, claims, incurred cost, etc., the general minimum criteria for the explanatory notes will include:

(1) Summary of Conclusions. Provide a brief summary of the audit exception. Provide the basis for any questioned or unsupported costs including a description of the costs and a specific reference to the regulatory support such as the cost principle, cost accounting standards, or contract terms.

(2) Basis of Contractor's Cost. Describe the basis of the contractor's submitted costs. As appropriate, provide references to the specific parts of the contract submission that provides more detail on the basis.

(3) Audit Evaluation. Provide a description of the audit procedures used to evaluate the cost element. Describe the procedures even if they did not result in questioned, unsupported or unresolved costs. Include details on the calculation of the audit exception. When quantitative methods are used as a basis for the audit conclusions, these methods

should be described in the explanation. Include references to any "Qualifications" and fully describe the effect these circumstances have on the submitted costs.

(4) Contractor's Reaction. Provide a statement that the contractor either agreed or disagreed with the auditor's conclusions and the basis for any disagreement.

(5) Auditor's Response. Provide any appropriate comments if the contractor disagrees with the auditor's conclusions.

c. For reports that do not deal with proposed costs, i.e., internal control examinations and operations audits, if there are findings, the explanatory note should follow 10-409, Statement of Condition and Recommendation which addresses the six-element outline used to present a logical audit position.

10-210.7 Contractor Organization and Systems

This section is designed to give the reader relevant information which impacts the scope and the results of the audit. Tailor it to the contractor's size and circumstances. When the contractor's systems information was provided to recipients in a previous report and there have been no changes, the prior audit report can be referenced in lieu of repeating the information.

a. The "Organization" paragraph should provide relevant background information such as annual sales, percentage of Government sales, number of employees, facilities, intercompany relationships, and major services and products provided by the company.

b. The "Systems" paragraphs in internal control audit reports on accounting and management internal control systems should provide pertinent information on the system (see 5-102). For example, this paragraph could refer to the contractor's written policies and procedures describing the system and briefly summarize the major areas covered by the policies and procedures. See 10-410 for an example of this paragraph. [The results of our internal control audits impact the scope of our attestation audits discussed below (see 3-305.4)].

c. The "Systems" paragraphs in attestation audits other than internal control audits should provide background information on each relevant internal control accounting and management system that impacts the evaluation (see 5-100). Include the following information for each relevant system:

(1) a brief description of the system or reference the previous internal control audit report or other reports that contain a description of the system. (If the addressee has not been provided a copy of the referenced report, attach a copy).

(2) our opinion on the overall system [adequate, inadequate, or inadequate in part].

(3) our assessment of control risk. The designation of low, moderate or high is not required but may be used for emphasis if desired. (See 3-300).

(4) a list of outstanding internal control deficiencies --- briefly describe each deficiency and the status of contractor corrective actions.

d. The assessment of control risk and the deficiencies listed in the "Contractor Organization and Systems" section that impact the area being audited should be discussed in the "Scope of Audit" (see 10-210.3).

e. The cost impact of any deficiencies affecting the audit should be described in the structured notes in the "Results of Audit" section.

f. During the audit, the auditor should ask about contractor's efforts to correct deficiencies and reflect the current status in the "Contractor Organization and Systems" section.

g. The "Contractor Organization and Systems" section should also be updated for new deficiencies observed during the audit (see 10-413).

10-211 DCAA Personnel and Report Authorization (Reports-General)

a. DCAA Personnel. For all reports, identify the primary point of contact for questions regarding the audit and provide telephone, e-mail and fax numbers where he or she can be reached. Include the telephone and fax numbers for the FAO as well as the onsite financial

liaison advisor, when applicable. Also provide the DCAA internet address (see Fig. 10-2-3). If an auditor trainee or auditor intern performed the fieldwork, do not identify him or her in this section. In this case, the supervisory auditor or cognizant technical specialist should be identified as the primary point of contact.

b. Signature.

(1) The report will be signed by the auditor authorized to do so in accordance with the provisions of DCAAR 5600.1, "Delegation of Signature Authority for Audit Reports and Other Related Documents," in most cases, the branch manager or resident auditor. No "command" or authority line is used on audit reports. As shown in Figure 10-2-3, "AUDIT REPORT AUTHORIZED BY:" is typed at the left margin below the last line of the narrative. The first line of the signature block is typed on the fifth line below this line.

(2) The signature on reports sent electronically should comply with the DCAA Correspondence Manual, C2.10.2.

/Signed/
ROBERT T. BROWN
Branch Manager
DCAA Arizona Branch Office

If someone other than the FAO manager signs the report use the following electronic signature format.

/s/ S. W. Jones
/for/ John W. Brown
Branch Manager
DCAA Arizona Branch Office

c. Relevant Dates. Use this section in customer requested assignments, primarily price proposal evaluations. These should include, at a minimum, the dates of ACO and PCO requests and the dates of any extensions. The format should facilitate computation of elapsed days (see Fig. 10-2-3).

10-212 Report Distribution and Restrictions (Reports-General)

10-212.1 General

a. A separate page should be provided, after the signature page, to advise the report recipient of report distribution and restrictions. If e-mail addresses are available, include them for each recipient who is willing to receive the report electronically. The distribution list should properly identify each organization, with the exception of DCAA Field Detachment, which receives a blind copy of audit reports.

b. The report distribution is placed above the report restrictions as illustrated in Figure 10-2-4. Place long distribution lists on a separate sheet or sheets following the signature page; however, the location of such long distributions will be referenced on this page (e.g., see Appendix X, page XX).

c. For OMB Circular A-133 requirements refer to 13-706.7 and Figure 13-7-1.

d. Other special distribution requirements pertaining to certain types of reports will be stated in the following sections of this chapter. Provide copies of reports on lower tier subcontractors to FAOs cognizant of the upper tier contractor. Provide the name of the upper tier contractor and relevant contract numbers for ease in routing the report.

e. See 10-2S1 for e-mail distribution requirements for U.S. Army Tank-Automotive & Armaments Command (TACOM) – Code DAAE07.

f. A copy of all audit reports for non DoD customers resulting from forward pricing, terminations, equitable adjustment claims, systems and incurred cost audits should be e-

mailed to DCAA- Non DoD-FLA as listed on the DCAA Intranet. Also see 15-100 for distribution requirements pertaining to non-DoD agencies.

g. See Figure 10-2-4 for restriction statements that should be included in reports. Restrictions 1, 2, and 4 in Figure 10-2-4 are mandatory for inclusion in all reports. The language in the figure should be used as shown except that the language in restriction 4 must be modified for the application of agreed-upon procedures reports (10-1011). Restriction 3 should be tailored for release applications as discussed in 10-212.2 and 10-212.3. Restrictions for release of the proposal report to an FMS customer are set forth in 10-307.3. In addition, if the report contains classified information, refer to 10-205.2 for guidance on classification markings. Restrictions used in applications of agreed-upon procedures are set forth in 10-1011.

10-212.2 Release of Audit Reports to the Contractor

a. As provided for in the Government Auditing Standards, DCAA routinely provides copies of draft reports for all audits, except those dealing with negotiation of forecasted costs or those dealing with costs potentially under litigation, to the contractor being audited for review and comment. (See also 4-303 and 4-304 regarding information to be discussed at interim and exit conferences.)

b. Except for the reports described in paragraphs c and d, either a copy of the report, or the Results of Audit section, or the Statement of Condition and Recommendation, and/or other relevant section(s), as appropriate, will be provided to the contractor at the exit conference in draft form for written comment. As discussed in 4-303, the details of significant audit findings are provided to the contractor for comment at the time they are discovered. This allows for quick turnaround once the complete draft report is provided, since all findings will have already been fully discussed with the contractor. The contractor should be provided a reasonable amount of time to analyze the audit results and to submit its response for incorporation into the final report. However, this time should be minimal since the audit issues were discussed on a real-time basis during the evaluation. If the contractor's response is not provided in a timely manner, the final report should be issued stating that the report was provided for comments to the contractor but the comments were not received in time to incorporate them into the final report. If written comments are received after the report was issued, prepare a supplemental report if it will serve a useful purpose.

c. In order to avoid disclosing the Government's negotiating position, draft reports that include forecasted costs to be used in negotiations are not provided to the contractor unless specifically authorized by the contracting officer (FAR 15.404-2(c)(1)(i)). The contracting officer may restrict the discussion of source selection information with an offeror (FAR 15.3). However, the auditor should fully discuss with the contractor any factual differences, unsupported items, cost or pricing data inadequacies, and CAS/FAR noncompliances and obtain the contractor's response for inclusion in the final audit report. Draft and final audit reports on the areas listed below are not provided to the contractor unless the contracting officer directs such release in writing.

- Individual Price Proposals
- Should Cost Reviews
- Forward Pricing Rate Proposals
- Evaluations of Part of a Proposal, including audits of specified cost elements and agreed-upon procedures
- FPR/FPI Price Redetermination Proposals, containing forecasted costs
- Equitable Adjustment and Termination Submissions, containing forecasted costs (refer to 12-507 for general guidance concerning equitable adjustment submissions)
- Other evaluations where the PCO restricts release to the contractor

The following contingent release statement shown on Figure 10-2-4 will be included as the third paragraph under "RESTRICTIONS" for these reports:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [insert name of contractor or subcontractor to which the report pertains]."

d. Draft and final reports that are of a privileged and sensitive nature (such as those reporting on unsatisfactory conditions (4-803.2) or which make reference to suspected irregular conduct or referral for investigation (4-700)) will not be provided to the contractor. These types of reports are not usually discussed with contractor representatives, and any inquiries concerning disclosure of the report information will be resolved in accordance with DoD 5400.7-R and the DCAA Freedom of Information Act Program.

e. The statement regarding release of the audit report solely at the discretion of the cognizant contracting agency pertains to the complete report including all appendices. Frequently, a Government technical evaluation report may be included as an appendix to the DCAA audit report. If, for any reason, the Government activity supplying a technical evaluation has any objection to release of its report to contractor representatives, this must be highlighted under the "Audit Report Distribution and Restrictions" section of the report. For example:

"The Defense Contract Audit Agency has no objection to release of this report. However, do not release the Government technical evaluation report included as Appendix XX of our report to [contractor or subcontractor name] without approval of [name of Government agency supplying technical report]."

f. Except for those reports described above which are not releasable, the final report will show the contractor as a recipient of the report (through the contracting officer). Final reports provided to the contractor through the contracting officer should omit the third paragraph shown in Figure 10-2-4 "RESTRICTIONS" related to DCAA having no objection to the release of the audit report. If the contractor requests a copy of any of these types of final reports after the report has been issued, coordinate with the contracting officer to determine if the contracting officer has any objection to DCAA providing a copy of the report directly to the contractor.

10-212.3 Release of Subcontract Audit Report to the Higher-Tier Contractor --- Proposals or Other Cost Submissions

a. When the report is on a subcontractor's proposal or other cost submission to a higher-tier contractor, the audit report "RESTRICTIONS" must contain a statement regarding the subcontractor's agreement or objection to release of the report or information to the higher-tier contractor. The release statement applies to all subcontract audit reports or summary information. The audit procedures on this matter are discussed in 9-106.4 for price proposals and 6-802.6 for incurred costs. The auditor should determine at the start of the audit whether the subcontractor would have any restrictions on release of the report to the higher-tier contractor. If so, the auditor should also discuss with the requestor if the audit should proceed, and if so, how the audit results could best be presented to provide for release to the higher tier contractor and maximize their usefulness to the recipient. (See 10-212.3d. below.)

b. The comment regarding subcontractor release restrictions will be included under the audit report "RESTRICTIONS." If a report is issued, the comment will appear either as a stand-alone comment or as a follow-on comment to the sentence provided in 10-212.2e., if required. If a cumulative allowable cost worksheet (CACWS) is issued, the comment may be included as a note in the CACWS.

c. If the subcontractor does not object to release of the report, use the following statements:

(1) If the sentence in 10-212.2c. is required, add the following as the second sentence in this paragraph:

"Nor does this Agency or [subcontractor name] object to release of this report to authorized representatives of [name of higher-tier contractor]. See Appendix XX for a copy of the subcontractor's release statement."

(2) If the sentence in 10-212.2c. is not required, the following comment should be used on subcontractor release restrictions:

"[Name of subcontractor] does not object to release . . ."

d. If the subcontractor objects to release of all or any part of the report information and the contingent release restriction (10-212.2c) is required, use a statement similar to the following:

"The Defense Contract Audit Agency has no objection to release this report, at the discretion of the contracting agency, to the authorized representatives of [name of contractor or subcontractor to which the report pertains]. However, please note that [subcontractor name] objects to release of this report [in its entirety] to the higher-tier contractor, [higher-tier contractor name], because [briefly summarize the reason(s) for the subcontractor's objection.] [If applicable, identify the specific information the subcontractor does not want released, delete 'in its entirety' above and add 'except to the extent that the subcontractor grants permission for its release.'] See Appendix XX for a copy of the subcontractor's statement of objection to release."

If the contingent release restriction (10-212.2c) is not required, use a statement similar to the following:

[Subcontractor name] objects to release of this report [in its entirety] to the higher-tier contractor, [higher-tier contractor name], because [briefly summarize the reason(s) for the subcontractor's objection.] [If applicable, identify the specific information the subcontractor does not want released, delete 'in its entirety' above and add 'except to the extent that the subcontractor grants permission for its release.'] See Appendix XX for a copy of the subcontractor's statement of objection to release."

e. If the subcontractor restricts release of only a portion of the report information (for example, historical labor hours), try to contain the restricted data in a schedule or appendix that can be conveniently removed from the report. In such a situation, the report "RESTRICTIONS" would include a statement describing what information cannot be released and advise that the report could be released if the restricted data were first removed. For example:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [insert name of contractor or subcontractor to which the report pertains]. However, please note that [subcontractor name] objects to release of this report to the higher-tier contractor, [higher-tier contractor name], unless Schedule/Appendix XX is first removed, because it contains [identify the data and briefly state the reason(s) for the subcontractor's objection]. See Appendix XX for a copy of the subcontractor's statement of objection to release."

10-213 Appendixes (Reports-General)

a. Appendixes may be used when additional background information is needed to help the reader obtain a full understanding of circumstances or events. Types of appendixes include:

- (1) Other Matters to be Reported;
- (2) Subcontracts Requiring Contractor Cost Analyses (see 10-308.2); and

(3) Chronology of Significant Events for postaward audits, equitable adjustment proposals and claims (see 10-607.1 and 10-1107.1).

The appendix entitled "Other Matters to be Reported" (10-308.1) is used to provide information, which cannot be conveniently shown in the exhibits and schedules and to present any financial management matters. Audit reports on annual indirect costs, may include an appendix on billing rates. When material is sufficiently important to an understanding of the audit as to require incorporation into an appendix, the text must specifically identify the appendix and briefly state its relationship to the point being made.

b. Appendixes may also be used when attaching stand alone documents that contain information which is pertinent to the audit. Examples of this type of appendix include such documents as assist audit reports, technical analysis reports, subcontractor release letters, contractor written responses, and indirect rate agreements.

c. When another report is referenced, (for example, when an estimating systems examination has disclosed a deficiency discussed in a price proposal evaluation) and the auditor does not know that the user has access to a copy, the referenced report should be furnished as an appendix.

d. Appendixes should be placed immediately after the Report Distribution and Restrictions section of the report. Refer to the appropriate section in this chapter dealing with the specific type of report being prepared for further guidance on the use of appendixes.

e. Identify appendixes by numbers in consecutive order; e.g., APPENDIX 1, APPENDIX 2, etc.

10-214 Supplemental Reports

10-214.1 Criteria for Use

a. Auditing standards provide for issuance of supplemental audit reports when the auditor subsequently becomes aware of information which, had it been known at the time the report was issued, would have affected the report conclusions.

b. A new report (with a different report number) rather than a supplemental report should be issued when the purpose of the report differs from the purpose of the original report. This is the case when a special report is issued to summarize results of audit in previously issued reports or when a follow-up report is issued on a system audit to determine if the contractor took adequate corrective action on reported findings.

c. A supplemental report has the same purpose as the original report, but generally revises the original report's conclusions or significantly modifies some of the report details. Before preparing a supplemental audit report, contact the contracting officer to determine if the supplemental report would serve a useful purpose. If not, do not prepare the supplemental report and document your discussion in the working papers.

d. Supplemental DCAA audit reports should be issued when:

(1) Events occurring after report issuance have a material effect on Government contract costs. Subsequent to the date of the audit report, the auditor concludes that one or more procedures considered necessary at the time of the audit, in the circumstances then existing, were omitted, if performance of such procedures results in significant findings.

(2) Subsequent to the date of the audit report the auditor became aware that additional facts regarding the subject of audit existed at the report date, and such facts affect the report.

(3) Additional time is needed to perform a complete audit (especially on major proposals, sensitive areas, or where there is potential for significant audit findings), however, circumstances do not permit a due date extension. In this case, a qualified report should be issued advising that a supplemental report will be forthcoming if negotiations have not been concluded and the report will serve a useful purpose.

(4) Relevant and material developments or events occurred after the date of the auditor's report that had a material effect on Government contract costs (such as, final determinations or resolutions of contingencies or other matters disclosed in the audit

report or that had resulted in a departure from the auditor's standard report), for example:

- Required technical information is received after the audit report is issued and the results have a significant impact on the audit findings [10-304.4f.(1)].
- Additional information is received which is necessary to reflect resolution of unresolved costs contained in the audit report [10-304.4f.(2)].
- Additional supporting information is provided by a contractor during the negotiation conference that would affect the report conclusions. In some cases a memorandum for record/file may substitute for a supplemental audit report (See 9-107).

FAR 15.404-2(c)(3) requires that contracting officers should provide updated information that will significantly affect the audit to the auditor. Auditors should assure that any subsequent audits comply with generally accepted government auditing standards, including adequate testing of evidential matter and appropriate supervisory review. If this cannot be accomplished, there should be no appearance of concurrence with the updated information or implied amendment of the audit report recommendations.

e. If a report is not being supplemented as described in d. above, but must be issued with minor changes (e.g., to correct minor math errors), it should be marked as "revised" in accordance with 10-214.6 below.

10-214.2 General Requirements for Supplemental Reports

a. A supplemental report need not supersede the original audit report in its entirety. It can be limited to the affected item(s) of cost or other portions of the prior report and need not restate previous information or recommendations. However, when a report has been furnished in electronic format, it may be easier to replace the original report in its entirety. Because electronic reports are furnished to the user in "read-only" format; incorporating replacement pages may present difficulties. The auditor should contact the report user to determine his/her preference regarding receiving a replacement report or receiving one or more replacement pages.

b. If replacement pages are selected, make the task of incorporating revisions as easy as possible for the report recipient(s). Rather than instructing the addressee to make numerous pen and ink changes and page substitutions, it is often easier to replace a complete exhibit or schedule in the original report with a revised exhibit or schedule.

c. If inserting a revised narrative, exhibit, etc. of more or fewer pages than the original would require the renumbering of the complete report, and it is not prudent to replace the original report in its entirety, it is acceptable to leave some pages blank or use decimals after the page numbers to keep the pages in sequence. For example, assume that the original report exhibit covered pages 5 through 10 and schedule A started on page 11:

(1) If the new exhibit is 8 pages long rather than the original 6, number the last two pages 10.1 and 10.2. No other changes to the original report need be made and schedule A can still begin on page 11.

(2) If the revised exhibit was only 4 pages long rather than the original 6, the last two pages of the revision could include the following statement: "This page intentionally left blank." As in the example above, schedule A would still start on page 11.

d. Dollars examined, questioned costs, unsupported costs, etc. initially reported will frequently require revision as a result of issuance of a supplemental audit report. As a result, performance data previously reported in the DCAA management information system should be revised as appropriate.

10-214.3 Supplemental Report Format

Major components of a supplemental report are listed below. Discussion of the particular elements is contained in the referenced paragraphs. Except where noted, the format and

contents of the supplemental report must comply with the basic audit report requirements in 10-204. For example, requirements for an audit report cover would not change, distribution requirements remain the same, etc.

Audit Report Cover Sheet (10-214.4)

Report Narrative (10-214.5)

Subject of Supplemental Audit

Executive Summary of Supplemental Audit

Scope of Supplemental Audit

Qualifications Affecting the Supplemental Audit

Results of Supplemental Audit

10-214.4 Audit Report Cover Sheet

a. The report cover sheet and all supplemented pages should contain the original audit report number followed by the supplement number (e.g., S1, S2, etc.). If the original exhibit is to be replaced by a revised exhibit, all pages of the revised exhibit should show the supplement number.

b. The audit report cover sheet and subject line should identify the audit report as a supplement; for example, "Supplement to Report on Audit of Proposal . . ." Otherwise, the cover sheet, subject, and addressee elements should be identical to the original report.

10-214.5 Report Narrative

The supplemental report can usually be limited to a narrative section setting forth the "Subject" and "Scope of Supplemental Audit," and "Results of Supplemental Audit" together with the attached supplemental exhibits, schedules, or individual pages. Comments on these areas follow:

a. Subject and Scope of Supplemental Audit. State the reason why the supplemental report is being issued. If applicable, mention whether the supplemental audit was limited to specific areas or items of cost. For example:

"This supplemental report incorporates the results of the Government report of technical evaluation, which was not received in time to be included in our original audit report dated . . ."

If there are any changes in the scope of audit statement as contained in the original report, make note of it in this paragraph. For example, a comment may be included that the scope of audit qualifications in the original report no longer apply.

b. Results of Supplemental Audit

(1) This paragraph will state the net effect of the supplemental report and the primary reason(s) for the change. For example:

"As a result of the technical review, total questioned costs of \$__ in our original report are revised to \$__, primarily because of recommended reductions to proposed material quantities and manufacturing labor hours."

(2) If applicable, state the name and title of the contractor's designated representative with whom the supplemental results were discussed (10-210.5e).

(3) Provide precise instructions to enable the report recipient to incorporate the new pages, exhibits, etc. into a complete (revised) report. In the example in a. above, extensive changes would be required as a result of incorporating the results of technical review. The original "Scope of Audit" paragraph would probably require revision and the "Qualifications" paragraph in the original report would have to be revised or eliminated in its entirety to delete the technical qualification; the "Results of Audit" paragraph would change to reflect the additional questioned costs and a change in the

opinion; the comment on the intention to supplement the report would be eliminated; and the exhibit(s) and or schedule(s) in the original report would change. In this situation, this instruction paragraph would probably state the following:

"This supplemental report replaces our original report in its entirety."

If the original report is not being entirely superseded, instruct the recipient to make pen-and-ink changes or page substitutions. For example:

"Remove pages 2, 4, 6, and 7 from our original report and replace with the attached revised pages. Also, renumber page(s) . . ."

In this case, add the following additional comment:

"Except as noted above, all other comments contained in the original report remain unchanged."

10-214.6 Revised Report Format

If an electronically furnished report is not being supplemented as described in 10-214.1d. above, but is being reissued in its entirety with minor changes (e.g., to correct minor math errors), the word "Revised," in parentheses, should follow the audit report number on the cover sheet and in the header. Since no additional fieldwork was performed, the revised report should not carry a revised date. Do not identify the superseded audit report as a supplement (see 10-214.4). If subsequent revisions become necessary, they are to be identified as "Revision 2," "Revision 3," etc. The transmittal should identify the minor change(s) unambiguously.

10-215 Transmittal Memorandums and Routing

Report transmittals should not be used to convey information or comments that should be included in the report itself. For this reason, a transmittal memorandum or letter is not normally used for initial distribution of reports. However, it is acceptable to attach a transmittal letter to a report if it is helpful in highlighting an area for the contracting officer's consideration. A transmittal letter could also be used to explain special distribution to officials who seldom receive reports from the FAO. For example, if a report discloses a condition which we have been requested to identify by an entity outside the procurement community, the transmittal memorandum might say:

"In accordance with your standing request to DCAA Headquarters, the attached report is distributed to your office because [*state the condition to be reported.*]"

June 30, 2006

Figure 10-2-1
Defense Contract Audit Agency Audit Report
DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. XXXX-XXXXX21000XXX

June 20, 20XX

PREPARED FOR: Procuring Contracting Officer
ATTN: AIR 2.2.1
Naval Air Systems Command Headquarters
Bldg. 2272
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

THRU: Administrative Contracting Officer
ATTN: DCMA-GXAF (J. Doe)
Defense Contract Management Agency, Phoenix
Phoenix, AZ 85034-1012

PREPARED BY: DCAA Arizona Branch Office
2741 W Southern Avenue Suite 14
Tempe, AZ 85034-3440
Telephone No. (602) 438-1854
FAX No. (602) 431-9745
E-mail Address dcaa-faoxxxx@dcaa.mil

SUBJECT: Report on Audit of Firm-Fixed-Price Proposal for Torque
Inverters for Orville I

REFERENCES: PCO: RFP No. N00019-XX-P1-XXXXX
ACO: Case No. XXX-3A(02)-XX
Prime Contract No.: F33600-91-C-0045
Relevant Dates: See Page 17

CONTRACTOR: High Tech, Inc.
29 Scout Drive
Glendale, AZ 85300

REPORT RELEASE RESTRICTIONS: See Page 18

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FOR OFFICIAL USE ONLY

Figure 10-2-2
Subject of Audit

Audit Report No. XXXX-XXXXX21000XXX

SUBJECT OF AUDIT

As requested by DCMA-Phoenix on May 14, 20XX, we examined the May 13, 20XX firm-fixed-price proposal submitted by High Tech, Inc. (HTI) to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The \$1,141,268 proposal is for 28 Torque Inverters for the Orville I aircraft. This is a product made by this contractor on a sole source basis for the past five years, delivering the last order in December 20XX. The proposed performance period is August through November 20XX.

The proposal and related cost or pricing data are the responsibility of HTI. Our responsibility is to express an opinion on the proposal based on our examination.

EXECUTIVE SUMMARY

Our examination of the \$1.1 million proposal disclosed \$169,000 of questioned costs, including the following significant items:

Material	\$86,000
Labor	9,000
Indirect expenses	66,000

The proposal is acceptable for negotiation of a fair and reasonable price. However, the significant issues described below should be considered in the negotiation process.

SIGNIFICANT ISSUES

1. The results are qualified because (i) we have not yet received a response to our request for technical assistance regarding purchased parts as discussed on page 4 and engineering labor as discussed on page 7 and (ii) HTI's noncompliance with CAS 401.
2. Costs proposed are overstated as follows:
 - a. Material costs by 24 percent because of numerous pricing errors as a result of an outstanding estimating deficiency.
 - b. Manufacturing labor costs by 12 percent because it did not use the appropriate historical accounting data in the improvement curve application.
3. Indirect expenses associated with questioned base amounts are also questioned.

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Figure 10-2-3
DCAA Personnel

Audit Report No. XXXX-XXXXX21000XXX

DCAA PERSONNEL

	Telephone No.
Primary contact(s) regarding this audit: Mary E. Green, Senior Auditor Kay J. Jones, Supervisory Auditor	(602) 561-3112 (602) 561-3112
Other contact(s) regarding this audit report: John W. Brown, Branch Manager John A. Smith, Financial Liaison Advisor	(602) 379-4102 (301) 757-7852
	FAX No.
[Office Name] (Optional) [FLA Name], Financial Liaison Advisor (Optional)	(602) 379-4601 (301) 757-7866 (FLA)
	E-mail Address
[Office Name] (Optional)	dcaa-faoxxx@dcaa.mil

General information on audit matters is available at <http://www.dcaa.mil>.

RELEVANT DATES

Request for Audit: PCO -- dated May 13, 20XX; received May 14, 20XX
ACO -- dated May 14, 20XX; received May 14, 20XX

AUDIT REPORT AUTHORIZED BY:

John W. Brown
Branch Manager
DCAA Arizona Branch Office

Figure 10-2-4
Audit Report Distribution and Restrictions

Audit Report No. XXXX-XXXXX21000XXX

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

Procuring Contracting Officer
ATTN: AIR 2.2.1
Naval Air Systems Command Headquarters
Bldg. 2272
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

E-mail Address
grayjs.jfk@navair.navy.mil

Administrative Contracting Officer
ATTN: DCMA-GXAF (J. Doe)
Defense Contract Management Agency
Phoenix, AZ 85034-1012

jdoe@dcma.mil

Naval Air Systems Command
ATTN: DCAA FLA (J. A. Smith)
Bldg. 2272 AIR 2.0
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

dcaa-fla-navair@dcaa.mil

Telephone No.
(301) 757-7852

RESTRICTIONS

1. Information contained in this audit report may be proprietary. It is not practical to identify during the conduct of the audit those elements of the data which are proprietary. Make proprietary determinations in the event of an external request for access. Consider the restrictions of 18 U.S.C. 1905 before releasing this information to the public.
2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.
3. The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of HTI.
4. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

10-2S1 Supplement -- E-mail Distribution of Reports

In cases where DCAA offices provide information copies of DCAA self-initiated audits or DCMA requested reports to the U.S. Army Tank-Automotive & Armaments Command (TACOM) – Warren procurement offices (identified by Army Activity Address Number DAAE07), the reports should be e-mailed to dcaaauditreports@tacom.army.mil. See 10-6S1 for distribution of defective pricing reports on any TACOM contract.

10-300 Section 3 --- Audit Reports on Price Proposals**10-301 Introduction (Proposal Reports)**

- a. This section presents guidance for preparing and distributing audit reports on:
 - audit requests on pricing proposals for all types of negotiated contracts and modifications, (10-304) and
 - audits of parts of a proposal, (10-305).
- b. Guidance on reporting applications of agreed-upon procedures may be found in section 10-1000.
- c. Audits of incurred costs under repricing proposals for incentive and price redeterminable fixed-price contracts are similar to other contract closeout audits. See 10-900 for reporting guidance on these types of audits.
- d. Guidance on audit reports related to contract claims is in 10-1100.

10-302 Report Format and Contents (Proposal Reports)

a. General report requirements are set forth in 10-200. "Shell" reports containing the new report format are provided on the APPS and the DCAA Intranet. The audit report should contain the necessary and pertinent information disclosed by the audit, which will assist the contracting officer in negotiating with the contractor.

b. The auditor should coordinate with the customer while planning the audit. Reports should comment on areas emphasized in the request. For example, customers may want historical rate information, current proposed and recommended rates, or details on specific proposed costs.

c. Major audit report components are listed below in the sequence in which they generally appear. They are discussed in detail in the referenced paragraphs. Those components highlighted with an asterisk should appear in every DCAA forward pricing audit report.

Audit Report Cover Sheet (10-205)*

Report Narrative (10-304)*

Subject of Audit (10-304.1)*

Executive Summary (10-304.2)

Scope of Audit (10-304.3)*

Qualifications (10-304.4)

Results of Audit (10-304.5)*

Opinion (10-304.6)*

Exhibits and Schedules (10-304.7)

Additional Remarks (10-304.10)

Contractor Organization and Systems
(10-306)*

DCAA Personnel and Report Authorization (10-211)*

Report Distribution and Restrictions (10-212)*

Appendix (10-308)

10-303 Addressing and Distributing Reports (Proposal Reports)**10-303.1 Reports on Prime Contract Proposals**

a. Reports on price proposal audits will usually be addressed to the individual who has responsibility for negotiating the proposal. This is either the PCO or the plant representative/ACO (if the PCO has delegated negotiation authority). (See 10-206 for general policy on addressing reports.) If there is doubt about the correct addressee, ask the plant representative/ACO if she or he has been delegated procurement authority to execute the contract pricing action involved.

b. If the report is addressed to the PCO (other than the plant representative/ACO acting as a PCO), and DoD field pricing support procedures apply (9-100), provide the original copy of the report to the plant representative/ACO for transmittal to the PCO. "Thru" addressing may be used for this purpose (see 10-206.4).

c. If "thru" addressing is used, provide an advance copy of the report to the PCO. This will allow the PCO to begin advance preparation for negotiations. A routing slip may be used for this purpose. In such cases, the audit report distribution list (10-212) should identify this advance distribution to the PCO.

d. Provide a copy of the report to the appropriate FLA (see the FLA Locator on the DCAA Intranet site). Also provide a copy of each prime contract price proposal audit report to the NASA OIG Center Director (see 15-1S1) if NASA so requests.

10-303.2 Reports on Intracompany and Subcontract Proposals

a. If this is a DoD procurement (9-100 and FAR 15.404-2 /DFARS 215.404-2), an audit report of an intracompany or subcontractor proposal will be addressed to the plant representative/ACO responsible for the segment or subcontractor submitting the proposal. Copies of the audit report will be distributed to the plant representative/ACO and auditor cognizant of the upper tier contractor. Note that the assist audit report should still be addressed and distributed in the above manner even if the assist audit was requested by DCAA (see 9-104.2 and 9-104.4).

b. If the procurement is not for DoD or is a foreign direct sale, and the PCO requests audit assistance directly from the prime contractor auditor, address the reports on audits of subcontractor and intercompany proposals to the requesting PCO. Provide a copy to the plant representative/ACO responsible for the audited segment or subcontractor, unless he or she expressly prefers not to receive copies of such reports.

10-304 Report Narrative (Proposal Reports)

10-304.1 Subject of Audit

a. This section refers to the audit request and identifies the contractor's assertion by stating the nature and amount of the pricing action (See 10-210.1). The opening statement could read as follows:

"As requested by [insert requestor's organization] on [insert date], we examined the [insert contractor's name]'s [insert date of proposal and type of proposal] proposal submitted in response to RFP number [insert RFP No.] to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The \$[insert price] proposal is for [describe product]. The Company proposed a performance period of [date] through [date]."

"The proposal and related cost or pricing data [or information other than cost and pricing data] are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

When the auditor participated as a member of an IPT, the second paragraph should read as follows:

"The contracting officer formed an Integrated Product Team (IPT) to effectively and efficiently manage the subject acquisition. At the request of the contracting officer, DCAA participated as a member of the IPT, but did not prepare the proposal. The proposal and related cost or pricing data [or information other than cost and pricing data] are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

b. Modify the opening for any additional cost or pricing data or information other than cost and pricing data submissions that were audited (e.g., a revised submission or supplemental data). If the effort performed was limited to agreed-upon procedures, reference to an examination should not be used. The last sentence should be modified to something like: *"The purpose of our engagement was to [insert purpose of engagement]."*

10-304.2 Executive Summary

a. The Executive Summary highlights the audit results and the significant issues, findings, recommendations and/or qualifications (see 10-210.2). Details are provided in the "Results of Audit" section, along with the explanatory notes, exhibits and schedules. Examples of results, which may trigger the need for an Executive Summary are:

- Adverse or Disclaimer of opinion (see 10-304.2c)
- Significant questioned, unsupported or unresolved costs
- Significant estimating system deficiencies
- Recommendation to delay contract negotiation
- Significant qualifications
- Significant instances of CAS or FAR noncompliance

b. Begin this paragraph with a summary of the amounts questioned, unsupported, or unresolved in relation to the amount proposed. Wherever possible, describe the major components of the questioned costs and state whether the proposal is [or is not] acceptable as a basis for negotiation. For example, a summary statement might read:

"Our examination of the \$1.1 million proposal disclosed \$169,000 of questioned costs, including the following significant items:

Material	\$86,000
Labor	9,000
Indirect expenses	66,000

The proposal is acceptable for negotiation of a fair and reasonable price; however, the significant issues described below should be considered in the negotiation process.

SIGNIFICANT ISSUES:

1. The results are qualified because (i) we have not received our requested technical analysis of purchased parts (see page 5) and engineering labor (see page 7) and (ii) the contractor is in noncompliance with CAS 401 (see page 6).
2. The contractor overstated:
 - a. Material costs by 24 percent because of numerous pricing errors as a result of an outstanding estimating deficiency.
 - b. Manufacturing and labor costs by 12 percent because it did not use the appropriate historical accounting data in the improvement curve application.
3. Indirect expenses associated with questioned base costs are also questioned."

c. Do not include questioned dollar amounts in the Executive Summary when an adverse opinion is issued in an audit report. Including dollar amounts for exceptions found might give the negotiator the impression that audit exceptions may be used for negotiating a contract price.

10-304.3 Scope of Audit

a. Every audit report requires a description of the work performed (see 10-210.3). The scope paragraph for proposal audits addresses the following:

- Generally accepted government auditing standards
- Evaluation criteria (FAR, DFARS, other Agency supplement regulations, and CAS)

- Internal control structure (assessed control risk)
 - Qualifications (10-304.4)
- b. Following is the mandatory scope paragraph. Auditors should adjust the criteria (i.e. applicable regulations and/or law) to fit the situation.

“Except for the qualifications discussed below (*omit if there is no “Qualifications” section within the “Scope” paragraph*), we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the proposal is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the proposal;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall proposal presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a Government technical evaluation report*].

We evaluated the proposed costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS) [*for non-DoD agencies, identify specific agency supplement - see 15-102.3*]; and
- Cost Accounting Standards (CAS) [*only if the potential contract will be CAS covered*].”

c. The next paragraph in the Scope of Audit section should comment on the results of audits of the contractor's accounting and estimating systems and the impact of the control risk assessments on the scope of the proposal audit. Ensure the comments are consistent with the information in the “Contractor Organization and Systems” section (see 10-306). Outstanding system deficiencies that impact the scope of audit should be disclosed until those deficiencies are corrected (see 5-1217).

For a contractor where internal control audits of the contractor's overall accounting and estimating systems have been performed, these comments might read as follows:

“We consider ABC's overall accounting and estimating systems to be adequate [*or inadequate, or inadequate in part*] (see Contractor Organization and System section). [*If inadequate or inadequate in part, briefly describe the impact of any outstanding deficiencies on the audit scope.*] The scope of our examination reflects our assessment of control risk and includes audit tests designed to provide a reasonable basis for our opinion.”

For a nonmajor contractor where an estimating system audit has not been performed, the following comments may be appropriate:

“We consider ABC's accounting system to be adequate [*or inadequate, or inadequate in part*] for accumulating and billing costs on Government contracts. We have not specifically examined ABC's estimating system and its related internal controls (see Contractor Organization and Systems section.) The scope of our examination reflects our assessment of control risk and includes tests of compliance with applicable laws and regulations that we believe provide a reasonable basis for our opinion.”

10-304.4 Qualifications

a. The scope of audit section will (see 9-212.2) disclose any circumstances that necessitate a qualified opinion. Only include circumstances with a significant impact on the conduct or scope of the audit and its results. Briefly describe each qualification and its impact on the scope and results of audit, referring to the report page number, exhibit, schedule, or appendix paragraph containing details. The negative impact of each qualification, including an estimated monetary impact, when possible, should be provided. If an estimated impact can not be provided, recommend that the contracting officer take action(s) to protect the Government's interest. Although Agency guidance specifically permits reference to an appendix, report qualifications usually affect an element of proposed costs. The results of audit paragraph is the preferred location for this information. If the potential impact of an issue is not significant, the report should not be qualified.

b. The FLAs have been asked to bring any audit reports which appear to have inappropriate qualifications to the attention of the Auditing Standards Division (PAS) in Headquarters. Such reports will be forwarded to the cognizant Regional Director, who will be asked to furnish his personal assessment to Headquarters.

c. Examples of items to be noted in the qualifications paragraph include:

- (1) lack of access to contractor records, including budgetary data (see 1-504)
- (2) time limitations on the scope of audit
- (3) failure to obtain the results of a requested assist audit or technical analysis
- (4) estimating system deficiencies that result in either significant unsupported costs or an estimate which is not current, accurate, and complete
- (5) instances of CAS or FAR noncompliance when the impact of these deficiencies could not be determined on the proposal being audited; however, these deficiencies are not considered significant enough to warrant an adverse opinion
- (6) deficiencies which render the accounting system inadequate for the contract type proposed
- (7) incomplete historical cost audits for prior years when the forecasted rates or recommended rates are based on those prior years
- (8) major contractor acquisitions, mergers and internal reorganizations that are so significant that the effect on the price proposal cannot be reasonably determined but is expected to be material.

The following subparagraphs provide sample paragraphs under various circumstances.

d. If the contractor has denied access to records or other pertinent data, identify the records or data and describe the resulting restrictions or limitations on the scope of the audit. (See FAR 15.404-2(d).) Sample statements describing an access to records problem and a contractor's failure to provide budgetary forecasts follow:

"We were denied access to labor cost estimating worksheets that are required to adequately evaluate the direct labor cost included in the proposal. We discussed this condition with Mr. R. Smith, ABC's Contoller, on October 1, 20XX and notified Mr. J. Jones, ACO, of the denial of access by telephone and memorandum on October 2, 20XX. See Page 6, Note 4 for further discussion. We were unable to evaluate this cost by other audit procedures. Therefore, the audit results are qualified to the extent that an examination of the records denied may disclose additional questioned costs."

"The contractor has not prepared budgetary forecasts for the entire proposed period of contract performance. [*Briefly explain what cost elements and period are not covered.*] In our opinion, comprehensive budgetary data are required to facilitate the preparation of reliable cost estimates and as a basis for financial control over costs during contract performance. We were unable to determine by other audit procedures the possible impact that budgetary data would have on the pro-

posed direct costs, indirect expense rates, and related allocation bases. See Page X, Note X for further discussion. Our opinion regarding these costs is therefore qualified."

"We discussed this deficiency with Mr. R. Smith, ABC's Controller on October 10, 20XX. Mr. Smith stated that ABC will prepare the budgetary forecasts and submit a revised proposal by October 20, 20XX. Upon receipt of a revised proposal, we will provide a supplemental report if contract negotiations have not been completed and the supplemental report will serve a useful purpose."

e. When the scope of audit is limited because of insufficient time, clearly indicate those areas in which an audit was not accomplished (9-212.4). State if additional time was requested but not granted, or granted only in part. An example of a statement to be included in this situation follows:

"We were unable to complete our examination of labor cost because of time limitations. [*Briefly explain the reasons why time was insufficient.*] We requested an extension of the audit report due date from [name] on [date]. The requested extension was not granted because [*briefly explain reason*]. Therefore, the results of our examination are qualified to the extent that a supplemental examination of labor cost may disclose additional questioned costs. See page XX, Note X, for further discussion."

f. If a requested technical or assist audit report is not received in time to be incorporated into the audit report, state that fact and, if known, the reasons for nonreceipt.

(1) Nonreceipt of technical input. The report should be qualified stating the adverse impact on the scope and results of audit based on not receiving the technical report for incorporation in the audit. Also provide a brief comment on the follow-up action taken to obtain the required technical information or report. State whether the technical evaluation will be performed and identify the organization responsible for performing it. Also provide a brief comment on the status of the technical evaluation, if known, and on any future reporting action contemplated after receipt of the report. If the required technical information is received after the audit report has been issued, prepare a supplemental report if it would serve a useful purpose at negotiations. (Further guidance on reporting the use of technical specialist assistance is provided in D-300. Detailed examples of report qualification statements are also presented in D-300.)

(2) Nonreceipt of Assist Audit Report. An example of a statement that could be used when waiting for an assist audit report follows:

"Analysis of available documentation in the contractor's files applicable to proposed subcontract costs showed that an evaluation by another DCAA office is needed to reach a definitive conclusion regarding the acceptability of the proposed subcontract costs. We requested an assist audit from our DCAA Resident Office at ABC Corporation. However, we did not receive the results in time for incorporation into this report. We anticipate receipt of the assist audit report on or about [date]. The results of the assist audit are considered essential to the conclusion of this examination. Therefore, the audit results are qualified to the extent that additional costs may be questioned based on the results of the assist audit of proposed subcontract costs. See page XX, Note X, for further discussion. Upon receipt of the assist audit report, we will provide a supplemental report if contract negotiations have not been concluded and the supplemental report would serve a useful purpose."

This example assumes that the results of the assist audit are considered essential and that the "Results of Audit" will recommend that negotiations not be held until the assist audit results are considered. The qualification should not be included if the assist audit results are not considered essential to the conclusion of the audit and negotiations.

g. If estimating deficiencies discovered during the proposal audit result in either significant unsupported costs or an estimate which is not current, accurate, and complete, provide a brief explanation of the deficient condition and the specific action required to correct it. (See 5-1217, 9-205, 9-310, and 10-413 for specific actions required.)

(1) An example of a qualification statement covering unsupported costs might read:

“A significant proportion of the contractor's proposed costs is unsupported. We sought the assistance of both the ACO and PCO and advised them on [date] of the items and the types of documentation necessary to support the costs (see Page X, Note X). If the contractor furnishes adequate supporting documentation prior to negotiations, we will provide a supplemental report to dispose of the unsupported costs if such a report would serve a useful purpose.”

(2) An example of a qualification statement covering an estimating deficiency discovered during the audit of a price proposal follows:

“We consider the procedure by which the contractor estimated the proposed direct labor cost to be unacceptable because the proposed hourly rates include unreasonable and unsupported increases for wage escalations. To correct the deficiency cited the contractor must develop new labor rates commensurate with the most recent union contract. A detailed discussion of the circumstances is presented on page X, Note X, of the Results of Audit.”

(3) As noted in the above qualification statement, a detailed discussion of the deficient condition should be included in the explanatory notes within the “Results of Audit” section.

(4) DFARS 215.407-5-70(g) requires that once a significant estimating system deficiency is cited, subsequent field pricing reports will mention the outstanding deficiency until it is resolved. Accordingly, the discovered deficiency should be added to the list of outstanding estimating deficiencies in the “Contractor Organization and Systems” section of the report (see 10-306). This listing should include a brief description of the deficiency and the status of contractor actions.

h. If instances of CAS and FAR noncompliance have a significant effect on the evaluation or the audit results, state this and define the specific corrective action the contractor needs to take. A detailed discussion of the deficient condition should be provided in the Contractor Organization and Systems section.

i. If the contractor's accounting system is inadequate to determine the costs under the contract type proposed, state this and identify the contractor action required to make the accounting system adequate. A detailed discussion should be provided in the Contractor Organization and Systems section of the report narrative.

j. If the only effective method available to the auditor for evaluating proposed indirect forward pricing rates requires reliance on the results of historical overhead audits for prior years, and such historical audits are not reasonably current, the circumstances should be described and the potential effect on the audit conclusions defined (see 9-702.2).

k. If the contractor is involved in a major acquisition, merger, or internal reorganization that is estimated to have a material impact on direct costs and indirect rates, state this and recommend a savings clause if appropriate. A detailed discussion should be provided in the Contract Organization and Systems section of the report.

10-304.5 Results of Audit

The Results of Audit section for forward pricing proposals consists of the following subsections which are discussed in greater detail below:

Audit Opinion (10-304.6)

Contractor's Submission and Audit Evaluation (10-304.7)
 Questioned, Unsupported and Unresolved Cost (10-304.8)
 Difference (10-304.9)
 Additional Remarks (10-304.10)

10-304.6 Audit Opinion - Pricings

Begin this section with the opinion paragraph. Reporting standards (see Chapter 2) require that the auditor express an opinion on the adequacy of submitted cost or pricing data or information other than cost and pricing data, compliance of the proposal with applicable regulations, such as FAR, Part 31 and CAS, and the acceptability of the overall proposal for negotiation of a fair and reasonable price. 9-212 provides additional information about the types of audit opinion.

a. The auditor's opinion on the assertion and submitted cost or pricing data or information other than cost and pricing data generally can be categorized in one of the following three areas:

- completely acceptable (adequate),
- generally acceptable except for some minor deficiency (inadequate in part), or
- unacceptable (not adequate).

FAR, Part 15 is often used in determining if the assertion is adequate (see 9-200). Additionally, the proposal may be in various degrees of compliance with promulgated Cost Accounting Standards or FAR, Part 31. For reporting purposes, these include:

- no instances,
- insignificant instances, or
- significant instances of noncompliance.

b. The auditor's opinion serves as the basis for the overall opinion on the acceptability of the proposal for negotiation of a fair and reasonable price. For example, an opinion that the assertion is not adequate or that significant FAR and CAS noncompliances exist will likely result in an overall opinion that the proposal is not acceptable as a basis for negotiation of a fair and reasonable price.

c. The following table, along with the subsequent paragraphs, can help to prepare an appropriate opinion paragraph. To use the table, read down and across under the appropriate categories for adequacy and compliance. The numbers where the lines intersect represent the corresponding numbers of the sentences found in Section d, Opinion Statements. Combine these sentences in the order shown to present a complete opinion statement for the report. Minor changes in wording, such as references to proper exhibits, pages and notes should be made to fit each specific report.

FAR/CAS Noncompliance	Adequacy of Cost or Pricing Data or Information Other Than Cost or Pricing Data			
	Adequate (9-212.1)	Inadequate In Part (9-212.2)	Not Adequate Contractor's Fault (9-212.3)	Not Adequate and Access to Data Denied (9-212.3)
No Instances	1,5,8 (1,5,15)*	2,5,13 (2,5,15)*	5,3,10	5,4,10
Insignificant Instances	1,6,12 (1,6,15)*	2,6,14 (2,6,15)*	6,3,10	6,4,10
Significant Instances	1,7,9	2,7,9	3,7,11	4,7,11

*Use these paragraphs when recommending that price negotiations not be concluded for a reason not resulting from the contractor's action or inaction (e.g., nonreceipt of a technical or assist audit report) (see 9-212; also see Appendix D-303 for examples of opinion statements qualified for nonreceipt of a Government technical evaluation). If significant non-compliances or inadequate cost or pricing data or information other than cost or pricing data are encountered, an appropriate combination ending with paragraph 9, 10, or 11 should be selected.

d. Opinion Statements. The following sentences (referenced in the above matrix) comment on the adequacy of the cost or pricing data or information other than cost or pricing data and the degree of compliance of the proposal with CAS and FAR and, when combined, provide a summary opinion statement on these issues. The comments on compliance with appropriate provisions of FAR generally relate to FAR, Part 31 on the cost principles. The contractor's degree of compliance with FAR, Part 15 serves as the basis for the opinion on the adequacy of cost or pricing data. If the report includes a qualification paragraph within the scope of audit, the audit opinion must be qualified. The audit opinion should be referenced to the qualification statement that resulted in the qualified opinion. For example, the report will state "In our opinion, except for the *(describe the qualification and the potential impact on the results)*." Every audit opinion should start with the words "In our opinion." Add "In our opinion" to the beginning of the first sentence selected in the matrix.

(1) "The offeror has submitted adequate cost or pricing data [*or information other than cost or pricing data*]."

(2) "The cost or pricing data [*or information other than cost or pricing data*] submitted by the offeror are inadequate in part (see comments on page __, Exhibit __, Note __). However, the inadequacies described are considered to have limited impact on the subject proposal."

(3) "The cost or pricing data [*or information other than cost or pricing data*] submitted by the offeror are not adequate (see comments on page __, Exhibit __, Note __)."

(4) "The cost or pricing data [*or information other than cost or pricing data*] submitted by the offeror are not adequate (see comments on page __, Exhibit __, Note __). In addition, the offeror denied access to data needed to evaluate the proposal, as described in the Scope of Audit section of the report." [*Before this paragraph is used in the report, (a) it should be cleared with the regional office, (b) the ACO and PCO should be advised and (c) the contractor should be informed of its content. Identify the specific data denied and explain why it is needed (see 9-205d and 10-210.4i).*]

(5) "The proposal was prepared in accordance with [*if CAS covered, add "applicable Cost Accounting Standards and"*] appropriate provisions of FAR Part 31" [*if an agency supplement to FAR applies (9-102.2 and 15-102.3), add "and the (name the agency) Supplement"*].

(6) "The proposal was not prepared in all respects in accordance with [*if CAS covered, add "applicable Cost Accounting Standards and"*] appropriate provisions of FAR Part 31" [*if an agency supplement to FAR applies (9-102.2 and 15-102.3), add "and the (name the agency) Supplement"*]. However, as discussed on page __, Exhibit __, Note __, the impact of the noncompliances is considered relatively insignificant."

(7) "The proposal was not prepared in all respects in accordance with [*if CAS covered, add "applicable Cost Accounting Standards and"*] appropriate provisions of FAR Part 31" [*if an agency supplement to FAR applies (9-102.2 and 15-102.3), add "and the (name the agency) Supplement"*] (see comments on page __, Exhibit __, Note __)."

(8) "Therefore, we consider the proposal to be acceptable as a basis for negotiation of a fair and reasonable price."

(9) "Because the [*FAR and/or CAS*] noncompliances are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [*contracting officer or representative*] by [*auditor*] of our office on [*date*]

and as confirmed in our [memorandum/letter] to you dated [date]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances."

(10) "Because the cost or pricing data [or information other than cost or pricing data] inadequacies are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [contracting officer or representative] by [auditor] of our office on [date] and as confirmed in our [memorandum/letter] to you dated [date]. To make the cost or pricing data [or information other than cost or pricing data] adequate, the offeror must [insert offeror actions needed to resolve the noted inadequacies/deficiencies]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances."

(11) "Because the noncompliances and inadequacies are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [contracting officer or representative] by [auditor] of our office on [date] and as confirmed in our [memorandum/letter] to you dated [date]. To make the cost or pricing data adequate, the offeror must [insert offeror actions needed to resolve the noted inadequacies and/or deficiencies]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances."

(12) "Because the [FAR and/or CAS] noncompliances are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price."

(13) "Because the cost or pricing data [or information other than cost or pricing data] inadequacies are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price."

(14) "Because the noncompliances and inadequacies are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price."

(15) "Nevertheless, in our opinion, the [name the item(s) considered essential] discussed in the Qualifications section of the report [is/are] significant enough to materially impact the results of the audit. Therefore, as discussed with [contracting officer or representative name and title] by [auditor] of our office on [date], we recommend that contract price negotiations not be concluded until the results of [item(s) needed] are considered by the contracting officer."

e. Disclaimer of Opinion. In rare instances constraints may be placed upon the auditor by the requestor (see 9-212.4a.) which necessitates a disclaimer of opinion. In these instances follow the specific guidance in 10-200 in issuing a disclaimer of opinion.

10-304.7 Contractor's Submission and Audit Evaluation

The second part of the "Results of Audit" section should present the contractor's submission and audit results by cost element in an exhibit type format with appropriate explanatory notes.

a. Exhibits and schedules included in the report will state the results of audit using columns labeled "Questioned Costs," "Unsupported Costs," and "Unresolved Costs" (see 10-304.8). These columns should be used only if costs are to be reported in them; otherwise, they should be omitted from the format. The exhibits and schedules should be supported by explanatory notes, and where appropriate, cross-referenced to the narrative body of the report.

b. A "Differences" column (proposed cost less questioned, unsupported and unresolved costs by element) may be included at the right of the exhibit, if this would be of value to the requestor.

c. Explanatory Notes. The auditor should use a structured format to give the reader a clear and complete presentation of the audit results and recommendations on all items in the contractor's proposal (see 10-210.6). Use the following subheadings, as appropriate, to structure your notes for each significant cost element in the contractor's proposal.

- Summary of Conclusions
- Basis of Contractor's Cost
- Audit Evaluation

- Contractor's Reaction
- Auditor's Response
- d. Audit Evaluation.

(1) When quantitative methods are used as a basis for the audit conclusions, this should be mentioned in the audit evaluation portion of the explanatory note for the individual cost elements examined. The note should adequately explain the computations and rationale supporting your conclusion; however, it need not include statistical measurements which are not relevant to price negotiations. For example, comments on confidence levels or confidence limits should not be included in audit reports unless the contractor has cited confidence intervals in its proposal as support for predicted costs.

(a) When costs are questioned based on a statistical sample, the report need not present the sampling plan, recommendations on individual items examined, or calculations of questioned costs, if the contractor has agreed with the audit conclusions. For example, the explanatory note might state:

"We applied scientific sampling techniques to the raw material cost estimate. We tested selected items by comparison with the quantitative requirements shown in the bill of material that the Government technical representative recommended for acceptance. We compared the dollar values for the selected items with the latest vendor quotations. We consider the contractor's solicitation of prospective sources adequate. In a number of instances, however, the material quantities or prices included in the contractor's estimate exceeded the requirements or lowest quotations, without adequate justification. Applying statistical projection techniques to this cost category on the basis of the exceptions noted, we questioned [amount] in estimated raw material costs."

(b) When costs are questioned based on a regression analysis or an improvement curve, the auditor's explanatory note should identify data used in the analysis and explain any differences between these data and amounts appearing in the contractor's cost representations. Graphic presentations of regression lines and improvement curves, whenever practical, should be included in the audit report. The report may also include computer printouts when there are indications that negotiators will find this information valuable during negotiations.

(2) When a contractor's price proposal for a fixed-price contract includes projected pension costs, and the contractor's pension plan is at or near full funding status, provide sufficient information for the contracting officer to understand the risk associated with such circumstances. If the results of a DCMA CIPR Center technical evaluation are incorporated in the results of audit, the basis of the technical evaluation findings regarding the rate of return on assets should be explained. This information should generally be included in the audit evaluation portion of the explanatory notes. Generally, this information will be included in audit reports on individual price proposals only if (i) the anticipated contract is fixed-price; (ii) a forward pricing rate agreement has not been executed; and (iii) the proposed pension costs are significant enough to impact the indirect rates if the pension costs are not incurred. An example of language that could be included in audit reports on individual price proposals follows and should be tailored to the specific circumstances. Similar language should also be included in audit reports on forward pricing rates.

"This audit report incorporates the results of the DCMA CIPR Center technical evaluation. The technical evaluation took no exception to the proposed pension costs. That evaluation assumes that pension plan assets will earn returns at a rate of return equal to the plan's assumed long-term valuation interest rate. The contractor's pension plan is currently at or near full funding status (i.e., current pension plan liabilities and the actuarial value of plan assets are nearly equal). Based on the pension plan's long-term valuation interest rate, the plan is projected to be underfunded for the entire forecasted period [or some of the forecasted accounting periods]. However, given the volatility in

the stock market, the possibility exists that the actual rate of return on plan assets could exceed the assumed long-term valuation interest rate, in which case the pension plan may be fully funded during the forecasted period. If the pension plan is fully funded in any given year, the pension costs projected for that year will not materialize, resulting in a windfall profit to the contractor on the anticipated fixed-price contract [*or for a report on forward pricing rates "on fixed-price contracts"*]. We recommend that the contracting officer consider these facts during negotiations."

For audit reports on individual price proposals, the paragraph should be expanded to include information regarding the impact on the contractor's proposal if the pension costs are not incurred. For example, a comparison may be included of the proposed indirect rates, adjusted for any audit exceptions, to what those rates would be if the projected pension costs are not incurred. (Only rates that would be materially impacted by pension costs should be included.) The auditor should consider the circumstances unique to each individual price proposal and the contractor's rate structure in determining how much information to provide and in what format. Audit reports should provide the contracting officer with sufficient information to clearly understand the potential impact on the negotiated price should the proposed pension costs not be incurred.

e. If the auditor has comments on profit, they should be provided in the explanatory notes and prepared in accordance with 9-900. Normally comments are limited to items that might affect quantifying weighted guideline factors. Do not show percentage computations under the weighted guideline method or application of an incentive profit formula either here or in an exhibit or schedule of the report. Examples of comments on the profit factor, "Contractor's Performance Risk -- Cost Considerations," are shown below (see 9-900 for other factors to be covered):

"The contractor does not consistently base its proposed unit prices on the latest production labor hours and material prices incurred for the same or similar units. Details on this estimating deficiency are presented in our Report [*insert report title, number and date.*] Specific reference to the deficiency and discussion of its impact on this pricing action are included on page X, Notes X and X, and Appendix X."

"The contractor has three engineering departments which differ greatly in the proportion of journeyman engineers and notable or scarce engineering talent employed in each department. This proposal is based on engineering performance by the department having the least amount of notable engineering specialties and the lowest level of engineering experience."

f. If specific elements of the explanatory notes are redundant (e.g., Basis of Contractor's Cost or Contractor's Reaction) they may be efficiently presented as a common note.

g. If there are a number of exhibits and schedules, that are best presented on separate pages, move them and the explanatory notes to the end of the Results of Audit section (after "Additional Remarks") and begin each exhibit and schedule on a separate page. A sample statement describing this realignment might read:

"We included appropriate exhibits and schedules detailing the contractor's submissions and our audit evaluation beginning with Exhibit A, page _."

h. Where we have no findings and the requestor has indicated that the information describing the basis of the cost and the audit evaluation would not be useful at negotiations; the auditor may include a brief statement, after the audit opinion, that the audit found no questioned, unsupported, or unresolved items. The usual exhibits, schedules and explanatory notes may be omitted.

10-304.8 Questioned, Unsupported and Unresolved Cost

a. CAM should not be cited as the reason for treating costs as questioned, unsupported, or unresolved (see Introduction to Manual, 0-002). When Government regulations are specifically mentioned or incorporated by reference in the contract or in the terms governing submission and negotiation of the price proposal, and costs are questioned based on such regulations, the specific reference should be cited in the explanatory note describing the circumstances underlying the questioned cost. The citation should be accompanied by an appropriate explanation of the audit conclusion in terms of the reasonableness, allocability, or other factors affecting the acceptability of the cost.

b. Questioned Costs. Those amounts on which audit action has been completed and which are not considered acceptable as a contract cost will be shown as questioned costs. This category includes amounts for:

- Those items specifically identified as unallowable under the contract terms, statute, public policy, applicable Government regulations, or legal advice.
- Those items which, although not specifically unallowable, are determined to be unreasonable in amount, contrary to generally accepted government accounting principles, or not properly allocable to the contract considering the relative benefit received or other equitable relationship.
- The impact on proposed costs of cost avoidance recommendations based on implementation of the cost reduction programs listed in 9-317.
- Those items questioned for other reasons, usually based on Government engineering or technical advice.

(1) If part of a cost element or account is not acceptable, only that part should be questioned.

(2) If a cost element in the contractor's proposal has been significantly understated, the understated amount should be shown in the Questioned Costs column in parentheses to denote an increase for that element. If a portion of the cost element is also questioned, the net amount should be reflected. An adequate explanation should be given in all cases.

(3) Explanations regarding questioned costs should be sufficiently informative to allow the reader to fully understand the basis for the audit conclusions. The explanations should normally be shown as footnotes to exhibits and supporting schedules.

c. Unsupported Costs. Costs should be classified as unsupported when the contractor does not furnish sufficient documentation to enable a definitive conclusion. Classification of costs as unsupported is of no value to the contracting officer. Therefore, the auditor should vigorously pursue action to obtain the needed cost or pricing data (see 9-205a.). These actions must be taken promptly to avoid delays in completing the audit. Also classify as unsupported any proposed subcontract where the ACO/PCO decided to wait for the contractor completion of the required cost analysis rather than request an assist audit (see 9-104.2d.).

(1) Prompt requests for assistance to both the ACO and PCO are critical and should be confirmed in writing. The auditor should clearly identify the data needed and state how its absence would affect the overall audit opinion.

(2) When all attempts fail (including ACO and PCO assistance) to obtain the necessary supporting data, the auditor should include comments in the audit report on the action taken and classify the costs as unsupported. This should also be shown as a qualification to the scope of audit.

(3) The report should state that the contractor was advised of the unsupported costs (see 4-304.2d.). The explanatory notes for items classified as unsupported costs will state the types of documentation considered necessary to adequately support the items and describe the auditor's efforts to obtain such documentation.

(4) Overhead and G&A expense applicable to unsupported costs should not be quantified in the Unsupported Costs column. The rates applicable to unsupported costs

should be stated in the explanatory notes so that the rates can be applied to any portion of the unsupported base costs not accepted by the contracting officer to develop the corresponding amount of additional unaccepted overhead and G&A costs. When costs are classified as unsupported in subcontract audit reports, the subcontract auditor will identify the subcontractor loading factors, including profit, in the explanatory notes or by separate schedule so that they may be easily applied to the corresponding base costs in the prime contract report.

d. Unresolved Costs. Failure to receive requested DCAA assist audit reports will necessitate classifying the applicable proposed amounts as unresolved (see 9-104). The unresolved classification is also used when there are significant incomplete subcontract pricing actions applicable to repricing proposals for incentive and fixed price redeterminable contracts. Costs should not be classified as unresolved in any circumstances other than those cited in this paragraph.

(1) The guidance in 10-304.7c. on the presentation of explanatory comments on questioned costs also applies to unresolved costs. Overhead and G&A expense applicable to unresolved costs will not be quantified in the Unresolved Costs column; however, applicable rates will be provided as described in 10-304.8c.(4).

(2) The additional information or action required before a definitive conclusion can be reached on unresolved items will be stated in the footnotes or in the narrative portion of the report, together with a statement of the auditor's intentions with respect to issuance of a supplemental audit report. This statement should be based on the criteria in (3) below and on the latest information available prior to release of the initial audit report.

(3) A supplemental report should be issued when costs in this category are resolved provided the contract negotiation has not been concluded and the report will serve a useful purpose. For example, subcontract costs may have been classified as unresolved in the audit report on the repricing of an incentive-type prime contract, pending negotiation by the contractor and subcontractor of a firm final subcontract price. In these cases, the prime contract price will usually not be finalized until a final price for the subcontract has been established. If this procedure is being followed, a supplemental report should be issued after a firm subcontract price has been established and the auditor responsible for the prime contractor has reviewed the data supporting the settlement. Any questions at that time regarding the current status of prime contract negotiations should be discussed with the contracting officer.

(4) The supplemental report need not restate the information or recommendations included in the prior report. It should be limited to unresolved items, unless their resolution affects other cost elements or a complete restatement would be more useful to the contracting officer.

10-304.9 Difference

a. A "Difference" column may be included in reports on price proposal audits. The "Difference" column is placed to the right of the last column in the "Results of Audit" group and is not a part of that group.

b. The "Difference" column is intended for the use of the contracting officer in preparing the Government's negotiation objective. It should show for each cost element the arithmetic difference between the amount proposed and the sum of the related questioned, unsupported, and unresolved amounts. The amounts in this column should not be regarded or referred to as "audit approved" or "recommended" amounts. When used, the "Difference" column should be supported by an explanatory note. For example, the explanatory note might state:

"The amounts in this column are presented solely for the convenience of the procurement activity in developing its negotiation objective. They represent only the arithmetic difference between the amounts proposed and the related questioned costs. You should not consider the amounts to be audit approved or recommended amounts.

DCAA does not approve or recommend prospective costs because the amounts depend partly on factors outside the realm of accounting expertise, such as opinions on technical and production matters.”

10-304.10 Additional Remarks

a. The last part in the “Results of Audit” section is reserved for additional remarks. This is an untitled section, it does not have a separate heading. In addition to the requirements related to the Results of Audit section in 10-210.5, consider the following as appropriate.

(1) If the technical evaluation discloses no exceptions to the quantitative or qualifications aspects of the proposal, include the following:

“A Government technical evaluation was performed by [agency]. The technical report took no exceptions to the proposal. See Appendix _ for a copy of the technical report.”

(2) If we rely on exceptions reported in the technical evaluation, the auditor should incorporate the recommendations into the audit conclusions. In such cases, include the following statement in the audit report:

“The audit conclusions incorporate the dollar effect of the recommendations contained in the [activity] technical report. See Appendix _ for a copy of the technical report.”

(3) If significant estimating deficiency(ies) had been previously identified and reported, but not yet resolved, a statement such as the following may be inserted into the proposal audit report:

“We reported estimating deficiencies at [insert contractor’s name] in Audit Report No. [insert number and date] (Appendix X). Some of these deficiencies remain uncorrected (see the Contractor Organization and Systems section of the report on page XX). The deficiencies affecting the subject proposal, and their impact, are described in the Scope of Audit paragraphs on page XX and on page XX, Notes X and X, of the Results of Audit.”

b. On proposals expected to result in contracts covered by DFARS clause 252.242-7002, Earned Value Management System, or DFARS clause 252.242-7005, Cost/Schedule Status Report, the auditor should provide comments on whether the contractor’s Cost/Schedule Control (C/SC) system is meeting the C/SC systems criteria on other contracts and include the impact of deficiencies being reported in C/SC systems surveillance reports (9-316b.).

c. Additional Remarks. Conclude the Results of Audit section of the report narrative as discussed in 10-210.5e. Hold an exit conference with the offeror (See 10-210.5e.(1) and (2)). In the report state the date and the name and title of the offeror’s designated representative with whom the factual matters were discussed. Do not disclose the dollar impact of the findings. If the report does not include an adverse opinion, include the offeror’s reaction to the factual differences and the major areas of difference likely to be pursued at negotiations. An illustration of the report paragraph is shown below:

“We discussed factual matters concerning our findings with [name and title of offeror representative] in an exit conference held on [date]. We did not provide the dollar impact of our findings. [Include a summary of the offeror’s reaction and major areas likely to be pursued at negotiations.]”

If the report includes an adverse opinion that indicates that the proposal is not acceptable as a basis for negotiation, it would be inappropriate to include the additional remarks appearing in 10-210.5e.(1)(b) and (2)(f), regarding items to be addressed and auditor at-

tendance at negotiations. If the proposal was evaluated at the request of the customer even though it was inadequate, tailor comments to fit the situation. For example:

“Significant findings that are contested by the contractor are discussed in the Results of Audit. We are available to provide you with assistance in resolving the reported findings. We discussed factual matters concerning our findings with [name and title of offeror representative] in an exit conference held on [date].”

d. If the report has a number of exhibits and schedules that are best presented on separate pages, it is appropriate to present your concluding remarks within the report narrative before beginning the exhibits and schedules. (See 10-304.7g.).

10-305 Report Narrative (Parts of a Proposal)

a. The guidance for a part of a proposal report applies when the auditor is asked to audit less than the complete proposal. Performance of audits by DCAA is discussed in 2-103. A part of a proposal could represent declarations regarding one or more entire cost elements (e.g., direct material, direct subcontracts and other direct costs) or portions of a cost element (e.g., direct labor rates or indirect rates). (See 9-108) The report narrative includes the same sections as discussed in 10-304. However, because we are auditing only parts of a proposal, section headings are revised to include the words “of Parts of a Proposal”.

b. In general, the wording in the individual report sections, as shown below, should be adapted to limit our report to the parts of the proposal that we were requested to audit.

c. The report on the audit of parts of a proposal includes:

- the auditor's opinion on the parts of a proposal that were audited, and
- a disclaimer of opinion on those parts that were not audited.

10-305.1 Subject of Audit of Parts of a Proposal

The subject of audit paragraph might read as follows if the audit was limited to direct material costs.

“As you requested on [date of request], we examined the direct material cost portion [amount] of [insert contractor's name]'s [proposal amount, type, and date] to determine if the part of the proposal examined is acceptable as a basis to negotiate a fair and reasonable contract price. [Insert contractor's name] submitted the proposal for [item proposed] in response to RFP No. XX. The contractor proposed a performance period of [date] through [date].

The proposed direct material cost and related cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the direct material cost based on our examination.”

10-305.2 Executive Summary of Parts of a Proposal

Because of the limited nature of audits of parts of a proposal, an Executive Summary paragraph is generally not needed. If an Executive Summary is appropriate, see 10-304.2.

10-305.3 Scope of Audit of Parts of a Proposal

a. Scope statements such as the following will be used for audits of parts of a proposal.

“As requested, we limited our audit to an examination of the proposed direct material costs. Except for the qualifications discussed below, *[omit if no Qualifications are included in the report or if the circumstances described do not have an adverse bearing on the auditor's conformance with auditing standards]*, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the parts of the proposal examined are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures for the parts of the proposal;
- assessing the accounting principles used and significant estimates made by the contractor in developing the proposed amounts for the parts of the proposal examined;
- evaluating the overall presentation for those parts; and
- determining the need for technical specialist assistance for the parts of the proposal evaluated *[and quantifying the results of a Government technical evaluation]*.

We evaluated the proposed direct material costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS); *[for non-DoD agencies, identify specific agency supplement - see 15-102.3]* and
- Cost Accounting Standards (CAS) *[omit if the potential contract will not be CAS-covered].*”

b. The next paragraph in the Scope section should comment on the results of audits of the contractor's accounting and estimating system internal controls that impact the parts of the proposal being examined and the impact of the control risk assessment on the scope of audit. (see 10-304.3)

c. See 10-210.3 for additional statements pertaining to technical reports and contractor CAS status that should be attached to the end of the scope statements when appropriate. Also see 10-210.4 and 10-304 for a discussion of report qualifications.

10-305.4 Results of Audit of Parts of a Proposal

a. Tailor the opinion matrix at 10-304.6c for the parts of a proposal examined. It is important for you to remember to read the entire subparagraph to ensure that it is fully modified to address only the parts of a proposal examined. For example, subparagraph 10-304.6c (2), (5) and (13) limited to the audit of direct material costs could be modified to read:

“In our opinion, the cost or pricing data submitted by the offeror in support of direct material costs are inadequate in part (see Note *X* on page *X*).”

“The amount proposed for direct material cost was prepared in accordance with applicable Cost Accounting Standards and appropriate provisions of FAR.”

“Because the cost or pricing inadequacies are considered insignificant, we believe that the proposed amount is an acceptable basis for negotiation of a fair and reasonable price for direct material costs.”

b. Because we have audited only parts of a proposal, we should disclaim an opinion on the proposal as a whole. This disclaimer may read:

"This report is limited to *[insert the names of the parts of a proposal examined]*. Accordingly, we express no opinion on the contractor's proposal taken as a whole."

c. The next part of the Results of Audit section provides the details on the parts of a proposal examined and the audit results. An example follows:

"We have questioned *[amount questioned]* of the *[total amount]* proposed for the direct material costs examined."

This summary statement may be followed with schedules showing the basis for the proposed material costs and the audit evaluation using the structured note format. Schedules and notes should address only the parts of a proposal examined.

d. Additional Remarks. See 10-304.10 for other requirements, such as documentation of the exit conference, which should be included in the report. Wording should be adjusted to reflect only the parts of the proposal examined.

e. Also see 10-210.5 and 10-210.6 for other requirements related to the Results of Audit section of the report narrative. In each case, wording should be adjusted to reflect only the specific cost elements audited.

10-306 Contractor Organization and Systems (Proposal Reports)

This section should give the reader background organization and systems information, which impacts the scope and the results of the audit. Tailor this information to the contractor's size and reference any other reports issued on the relevant systems. (See 10-210.7)

a. The "Organization" paragraph should include background information (e.g., sales information, major products and services, intercompany relationships, percentage of Government business, etc.) considered pertinent to the audit and the negotiation.

b. The "Systems" paragraphs for proposal audits would usually describe the contractor's accounting and estimating internal control systems -- both of which impact the scope of pricing audits. These paragraphs would provide the following information for each system:

(1) a brief description of the system or reference to a prior audit report that provides a current description. (Provide a copy of the referenced report if it has not been previously distributed to the addressee. It can be attached as an appendix.)

(2) an opinion on the overall system [adequate, inadequate, or inadequate in part] or a statement that we have not specifically audited the contractor's system.

(3) our assessment of control risk [the designation of low, moderate or high is not required but may be used for emphasis if desired] and the impact of this risk on the area being audited.

(4) a list of outstanding internal control deficiencies including a brief description of each deficiency and the status of contractor corrective actions.

The impact of the control risk assessment and any outstanding deficiencies on the proposal audit would be described in the "Scope of Audit" section of the report (see 3-305.4 and 10-304.3).

c. Accounting System Internal Controls. Examples of accounting system deficiencies that might impact the pricing audit include:

(1) The contractor's accounting system is not adequate to determine the costs under the type of contract awarded or anticipated to be issued.

(2) The contractor's accounting system does not provide for costing by lots, batches, or runs. As a result, learning or improvement curve techniques cannot be used to evaluate the contractor's initial pricing proposals for production contracts.

d. Estimating System Internal Controls. The sample systems section paragraphs for a contractor's estimating system (providing the information described above) might read:

“ESTIMATING SYSTEM”

“We examined [insert contractor's name] estimating system and issued Audit Report No. [insert report number, and date], previously provided to your office. Our report found [insert contractor's name]'s estimating system and the related internal control policies and procedures inadequate in part to ensure that proposals and final certified contract prices are based on accurate, complete, and current cost or pricing data. As a result of these deficiencies, the ACO disapproved the material portion of the estimating system on [date].”

“Based on our understanding of the estimating system internal control structure policies and procedures, we determined that certain estimating methods are deficient. As a result of the following listed outstanding estimating deficiency, we assess the risk for overestimating material costs as high and have adjusted our audit scope accordingly.”

“Outstanding Estimating Deficiencies”

“Deficiency: [insert contractor's name] does not have effective internal controls to ensure that proposed material costs are based on current vendor quotes, recent historical prices, or reflect vendor prompt payment or quantity discounts. As a result, proposed material costs are often overstated.”

“Status: [insert contractor's name] agrees and is currently revising its estimating policies and procedures to correct this deficiency. After the policies and procedures have been revised, training will be provided to all [insert contractor's name] estimators. [Insert contractor's name] expects to complete these actions by [date].”

10-307 Report Distribution and Restrictions (Proposal Reports)

This section of the report will advise the recipient of report distribution and restrictions. See 10-212.1 for general information on this area.

10-307.1 Release of Audit Report to the Contractor

Reports on price proposals are not provided to the contractor unless the contracting officer directs such release in writing. See 10-212.2 for information and restrictions on releasing the report to the contractor.

10-307.2 Release of Subcontract Audit Report to the Higher-Tier Contractor

When the report is on a subcontractor's proposal to a higher-tier contractor, the report “RESTRICTIONS” must contain a statement regarding the subcontractor's agreement or objection to release of the report or information to the higher-tier contractor. See 10-212.3 for information and restrictions on releasing the subcontract audit report to the higher-tier contractor.

10-307.3 Release of Audit Report to FMS Customers

a. When the contracting officer identifies that the price proposal is for an FMS customer, the auditor should determine at the start of the audit whether the contractor objects to the release of the report to the FMS customer. The audit procedures on this matter are discussed in 9-110. The audit report “RESTRICTIONS” must contain a statement regarding the contractor's agreement or objection to release of the report or information to the FMS customer. The contractor's letter should be included as an appendix to the audit report.

b. If the contractor objects to release of the report to the FMS customer, use a statement similar to the following:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [name of contractor] or [FMS Customer]. However, please note that [name of contractor] objects to the release of the propriety data contained in this report to [FMS customer]. See Appendix XX for a copy of the contractor's statement objecting to release of the report."

c. If the contractor does not object, the following comment should be used in the release restrictions:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [name of contractor]. Nor does this Agency or [name of contractor] object to release of this report to authorized representatives of [FMS customer]. See Appendix XX for a copy of the contractor's release statement."

d. If the contractor does not respond to the auditor inquiry, use a statement similar to the following:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [name of contractor] or [FMS customer]. We asked [name of contractor representative and title] on [date] if [name of contractor] objected to the release of the propriety data contained in this report to [FMS customer]. As of the date of this report, we have not received a response to our inquiry."

10-308 Appendixes (Proposal Reports)

As described in the following subparagraphs, appendixes may be used to provide other information when needed. However, when you issue recurring reports to the same addressee concerning the same contractor, consider reducing the appendix material. Wherever feasible, include information in the narrative body of the report, exhibits, and/or schedules rather than in a separate appendix. For example, deficiencies in the contractor's accounting system or internal controls which are directly related to questioned cost for an element of the proposal should be explained in the applicable note rather than referring to an appendix.

10-308.1 Appendix --- Other Matters To Be Reported

a. Use this appendix, if needed, to furnish information which cannot be conveniently shown in the exhibits and schedules and to present any other financial management matters related to the proposal which should be brought to the attention of the contracting officer.

b. If the contracting officer requests specific information on the status of the contractor's systems such as purchasing system, compensation system, or automated data processing system, this information may be provided in this Appendix.

10-308.2 Appendix --- Subcontracts Requiring Contractor Cost Analyses

Use this appendix to identify subcontracts for which the contractor has not completed cost analyses required by FAR 15.404-3 (see 9-104.1). Provide this information even if assist audits have been performed or the auditor has reached a definitive conclusion by other means (e.g., applying a decrement factor or rate check). In the appendix, include the names of the subcontractors, proposed amounts, and the following explanatory note:

"FAR 15.408, Table 15-2 requires prime contractors and higher-tier subcontractors to conduct cost analysis of each subcontract proposal for which cost or pricing data

are required. In coordinating the need for assist audits, we informed *[insert name(s) of ACO/PCO or representatives]* on *[insert date]* of the contractor's planned schedule for completing the cost analyses. As of *[insert date field work completed]*, *[insert contractor's name]* had not completed the required cost analyses for the subcontractors listed above. The contractor's scheduled date for completing the cost analyses is *[insert revised date(s)]*. These analyses should be submitted to the contracting officer prior to completion of prime contract negotiations."

10-308.3 Appendix --- Incorporation of Government Technical Reports

a. See 9-103, 9-307, and Appendix D-300 for specific procedures on obtaining technical assistance/reports and for guidance on incorporating technical information/opinions into the audit conclusions and information to include in this appendix if that information cannot be effectively presented in the body of the audit report. The audit report should include an electronic or scanned version of all technical analyses received by the auditor and a quantification of the dollar effect of the technical analysis findings.

b. The report prepared by the Government engineering specialist shall be used unless the findings are, in the auditor's opinion, unrealistic. The auditor shall attempt to reconcile any disagreements concerning the findings with the engineering specialist and/or the responsible supervisory personnel. Assistance to resolve the differences shall be solicited from the contracting officer, if necessary. If the auditor is unable to resolve the differences, the technical report shall not influence formation of the audit opinion or the development of the questioned cost. However, the audit report shall include the technical report as an appendix and explain why it was not used.

10-400 Section 4 --- Audit Reports on Operations and Internal Control (System Audits)

10-401 Introduction (System Reports)

a. This section provides guidance for preparing and distributing reports on
(1) audits of the economy and efficiency of contractors' operations; and
(2) internal control audits of contractor accounting and management (business) systems (see Chapter 5). Generally accepted government auditing standards (see chapter 2), provide differing reporting standards for attestation and performance audits. GAGAS identifies most DCAA audits as attestations; economy and efficiency (operations) audits as performance audits; and provides listings of the types of evaluations that fit these categories. For reporting on attestations, GAGAS incorporates reporting standards from the AICPA's Statements on Standards for Attestation Engagements; for reporting on performance audits, GAGAS provides less detailed guidance in chapter 8 of the Yellow Book. GAGAS identifies most audits of internal controls as attestations.

(3) System audits (both operations audits and audits of internal control) address the system's adequacy to provide specific capabilities needed for contract or business purposes.

b. Reports on the results of audit of economy and efficiency of contractors' operations, and internal control audits of contractor business systems, are referred to as system reports.

c. Supplemental guidance for performing estimating system surveys is presented in 5-1213, supplemental reporting guidance for compensation audits is presented in 5-812, and supplemental reporting guidance for all internal control audits is presented in 5-110 and 5-111.

d. These audits and surveys may be initiated (1) upon request of the contracting officer, or (2) as part of the field office's responsibility for evaluating contractor systems and day-to-day operations.

e. A requestor may ask DCAA to evaluate limited portions of contractor systems by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of system reports. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an "examination" or a "review";
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-402 Nature of Reports (System Reports)

These audit reports are designed to provide an independent assessment of performance (i.e., operations audits, sometimes referred to as economy and efficiency audits) or compliance with internal control policies and procedures. The report provides an audit opinion on whether the contractor is fulfilling its responsibilities in a specific area and gives the contractor and contract administration officials information and recommendations to facilitate corrective actions and improvements.

10-403 Report Format and Contents (System Reports)

a. Consistent with the guidance in 10-200, reports will typically include the following sections:

- Cover Sheet
- Subject of Audit*

Executive Summary
 Scope of Audit*
 Qualifications (if applicable)
 Results of Audit*
 Opinion
 Statement of Condition and Recommendations
 Additional Remarks
 Contractor Organization and Systems
 DCAA Personnel and Report Authorization
 Audit Report Distribution and Restrictions*
 Appendixes

*Section headings for real time (flash) reports differ (10-413).

b. GAGAS incorporates the AICPA's Attestation Standards (AT) chapter 5, which prohibits negative assurance on internal controls. These evaluations may be reported on only as examinations or as applications of agreed upon procedures (see 10-1000).

c. Operations audits are not subject to Attestation Standards (AT), therefore do not use the terms "examination" or "review" in the report narrative to describe the subject or purpose of audit.

d. "Shell" reports for most assignments can be found on the DCAA Intranet and the APPS.

10-404 Cover Sheet (System Reports)

a. Follow the general guidance in 10-205 and 10-206 when preparing the cover sheet. All system reports, regardless of reported conditions, internal control weaknesses, or system deficiencies, will be addressed to the principal cognizant ACO (10-206). For reports involving more than one segment of a company, this will usually be the CACO, unless the segments involved are in the same location and assigned to the same contract administration office. In such cases, the auditor should consider wider report distribution to include segment ACOs and the CACO.

b. For audits on economy and efficiency (operations audits), report distribution should also be made to those buying activities that will be materially impacted by report recommendations (both direct and indirect cost).

10-405 Subject of Audit (System Reports)

a. For reports on economy and efficiency (operations audits), this section will clearly identify the area evaluated and the objective. For example, the subject of audit paragraph may read:

"As part of our comprehensive audit of the [*insert contractor's name*], we evaluated the contractor's plant maintenance function, which is responsible for the maintenance and repair of equipment and buildings at the Boston facility. We performed the audit to evaluate the effectiveness of the contractor's policies and practices in assuring that maintenance tasks are carried out in a timely, efficient, and economical manner. The audit was conducted from [*start date, month, year*] through [*field work complete date, month, year*] and covered contractor operations for the fiscal year ended [*date*]."

b. For audits of contractor business systems (internal controls; Chapter 5), the subject of audit paragraph may read:

"We have examined the [*insert contractor's name*]'s [*insert system examined*] as of [*insert date audit field work was completed*] to assure [*insert contractor's name*]'s [*insert system examined*] and related internal controls:

We evaluated the contractor's cost accounting practices used to accumulate contract costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

c. The following is an example of a paragraph to use when noncompliance is found during a proposal evaluation:

“We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the proposal complies with the requirements referred to above. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the cost accounting practices;
- assessing the cost accounting practices used in estimating and compliance of those practices with the disclosed and/or established cost accounting practices and applicable requirements; and
- evaluating the overall proposal presentation.

We evaluated the contractor's cost accounting practices used to estimate costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

d. The next paragraph in the scope section should describe the impact of the current assessment of control risk (e.g., Environment and Overall Accounting Controls) on the audit scope (see 10-210.3f). As required by the AICPA Statement on Standards for Attestation Engagements (SSAE), AT 601.55g, end the Scope section with the following statement:

“Our examination does not provide a legal determination on [*short name's*] compliance with the specified requirements.”

10-808.4 Qualifications

Scope limitations should not be reported as qualifications, but should be included in the Scope of Audit as discussed 10-210.4i.

10-808.5 Results of Audit

- a. Opinion. This paragraph presents a summary statement of the noncompliance(s) being reported. An example follows:

“In our opinion, during this period (*state period covered by the audit*) the contractor was in noncompliance with CAS 4XX [*and FAR Part 31*]. As of the date of this report, the condition causing the noncompliance has [*has not*] been corrected.”

- b. The paragraph will include the following report qualification:

“This report is limited to the cited instance(s) of noncompliance. Accordingly, we express no opinion on whether other practices are proper, approved, or agreed to for pricing proposals, accumulating costs, or reporting contractor performance data.”

c. Statement of Conditions and Recommendations. The paragraph should begin with one of the following statements:

(1) "Our examination identified a disclosed [*or established*] contractor practice which we believe is in noncompliance with the Cost Accounting Standards [*and/or FAR Part 31*], as follows:" or

(2) "Our examination disclosed that the contractor's failure to comply with a Cost Accounting Standard [*and/or failure to follow consistently a disclosed cost accounting practice*] has resulted or may result in increased cost paid by the Government. The areas of noncompliance and/or failure to follow disclosed practices are stated below:"

d. Separately list each noncompliance item, with the following information:

(1) Condition. Provide an introductory paragraph that includes a brief summary of the nature of the noncompliance, including a specific reference to the regulatory support for the noncompliance (e.g., 48 CFR 9904.401-40(a)); the time period during which the contractor was in noncompliance; and, an explanation of the significance of the noncompliance. Then describe the contractor's noncompliant accounting practices in sufficient detail to provide the CFAO with a thorough understanding of the nature and extent of the noncompliance. Describe the audit procedures used to evaluate the accounting practice.

(2) Recommendation. Provide a specific recommendation for corrective action with a statement about any acceptable alternative solutions proposed by the contractor.

(3) Contractor's Reaction. Provide a statement that the contractor either agreed or disagreed with the auditor's conclusion and the basis for any disagreement.

(4) Auditor's Response. Provide appropriate comments if the contractor disagreed with the auditor's conclusions and recommendations.

e. Include a statement regarding the contractor's responsibilities under the CAS administration clause at FAR 52.230-6(a). This statement may read as follows:

"Within 60 days of the contractor's agreement to the initial finding of noncompliance or the CFAO's determination of noncompliance, the contractor is required to submit a general dollar magnitude of the noncompliance that identifies the potential shift of costs between CAS-covered contracts and subcontracts by contract type (i.e., firm-fixed-price, incentive, cost-plus-fixed-fee, etc.) and other contractor business activity from the date of the initial failure to comply until the date the noncompliance is corrected. The analysis should also identify the potential impact on funds of each affected Government agency and department."

f. Additional Remarks. Provide additional remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary may read as follows:

"We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*]. In response to our findings, [*provide contractor's reaction, if any.*] [*If there was no response, the following is an example of a statement that is permissible but not required. (Identify the contractor representative)*] reserved comment pending discussions with the cognizant Federal agency official.]"

10-808.6 Contractor Organization and Systems

Use this section to provide supplementary information on the contractor's operations and systems necessary for a better understanding of the circumstances surrounding any reported

noncompliance and the auditor's recommendation. Refer to 10-210.7 for general guidance on preparing this section.

10-808.7 Report Distribution and Restrictions - Noncompliance

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-809 Audits on CAS Cost Impact Proposals

This section describes the format for audit reports on evaluations of cost impact proposals.

10-809.1 Subject of Audit

a. This paragraph should reference the audit request, other related audit reports (e.g., noncompliance reports), and any other documents that contain pertinent information about the contractor's cost impact proposal. The information contained in the referenced documents should not be duplicated in the cost impact audit report. Also include the date of the contractor's cost impact proposal.

b. Reports on cost impact proposals for cost accounting practice changes should include a summary description of the change and the effective date of the accounting practice change.

(1) The changed accounting practice should be described and categorized as either a:

(a) Required change resulting from either the implementation of a new standard or a prospective change from one compliant practice to another that is necessary for the contractor to remain in compliance (equitable adjustment),

(b) Unilateral change that is not deemed desirable by the cognizant Federal agency official (CFAO) (no increased costs to the Government), or

(c) Desirable change that was deemed desirable and not detrimental to the Government by the CFAO (equitable adjustment).

(2) An example of an acceptable statement for a required cost accounting practice change follows:

"As requested by your September 30, 20XX letter, we examined the XYZ Corporation's August 31, 20XX cost impact proposal reflecting the contractor's cost accounting practice change from a total cost input base to a value-added base for the allocation of general and administrative (G&A) expenses, effective November 1, 20XX. Since the CFAO has determined that the accounting change is required, the contractor is subject to the provisions of FAR 52.230-2(a)(4)(i), and the parties will negotiate an equitable adjustment."

(3) An example of an acceptable statement for a unilateral cost accounting practice change follows:

"As requested by your September 30, 20XX letter, we examined the XYZ Corporation's August 31, 20XX cost impact proposal reflecting the contractor's cost accounting practice change to combine the engineering and logistics overhead pools, effective November 1, 20XX. Since the CFAO has not determined that the accounting change is a desirable change, it is considered to be a unilateral change. Therefore, the contractor is subject to the provisions of FAR 52.230-2(a)(4)(ii), and the Government will not pay increased costs in the aggregate."

(4) An example of an acceptable statement for a desirable cost accounting practice change follows:

"As requested by your September 30, 20XX letter, we examined the XYZ Corporation's August 31, 20XX cost impact proposal reflecting the contractor's cost accounting practice change to combine the engineering and logistics overhead pools, effective November 1, 20XX. Since the CFAO has determined that the accounting change is a desirable change, the contractor is subject to the provisions of FAR 52.230-2(a)(4)(iii), and the parties will negotiate an equitable adjustment."

c. Reports on cost impact proposals resulting from CAS noncompliances should include a summary description of the noncompliance, reference the audit report number under which the noncompliance was reported, and provide the dates during which the contractor was in noncompliance. The date on which the contractor corrected the noncompliance should also be reported, if the contractor has completed corrective action. An example of an acceptable statement for a noncompliance follows:

"As requested by your September 30, 20XX letter, we examined the XYZ Corporation's August 31, 20XX cost impact proposal for the contractor's failure to comply with CAS 4XX for the period January 1, 19XX through May 31, 20XX, the date upon which the noncompliance was corrected. The noncompliance was previously reported in Audit Report No. XXXX-2003D19404001, dated March 1, 20XX. Since the CFAO has determined that the contractor failed to *[comply with the Cost Accounting Standards or follow consistently its disclosed accounting practices]*, the contractor is subject to the provisions of FAR 52.230-2(a)(5), and the Government will not pay increased costs in the aggregate."

d. In each audit report on a cost impact proposal, end the Subject of Audit with the following sentence:

"The cost impact proposal and related supporting data are the responsibility of the contractor. Our responsibility is to express an opinion on the cost impact proposal based on our examination."

10-809.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2.

10-809.3 Scope of Audit

a. Insert the following paragraph:

"Except for the qualifications below *[omit if there are no 'Qualifications' in the report]*, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the cost impact proposal is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the cost impact proposal;
- assessing the accounting principles used and significant estimates made by the contractor; and
- evaluating the overall cost impact proposal presentation.

We evaluated the contractor's cost impact proposal using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR) 30.6; and
- CAS Board Rules and Regulations, 48 CFR 9903.306.”

b. The next paragraph in the scope section should describe the impact of the current assessment of control risk (e.g., Environment and Overall Accounting Controls) on the audit scope (see 10-210.3f.).

10-809.4 Qualifications

Separately identify and describe any special circumstances adversely affecting the audit or its result as discussed in 10-210.4. If applicable, include a qualification about the completeness and accuracy of the universe of CAS-covered contracts.

10-809.5 Results of Audit

a. Begin this paragraph with an opinion statement on the adequacy of the data submitted by the contractor. If the report includes a qualification paragraph within the scope of audit, the audit opinion must be qualified.

(1) The report on a cost impact proposal for a required change could read:

“In our opinion, *[except for the (describe the qualification and the potential impact on the results),]* the contractor has submitted data that *[, although not adequate in part (see comments on page __, note __),]* are acceptable for negotiating the cost impact due to the required change. We have determined that the required change will result in increased *[decreased]* costs to the Government on CAS-covered contracts and subcontracts in the aggregate of \$ _____. We recommend that the CFAO negotiate an equitable adjustment in accordance with FAR 52.230-2(a)(4)(i). Our detailed findings and recommendations are included in Exhibit ____.”

(2) The report on a cost impact proposal for a unilateral change could read:

“In our opinion, *[except for the (describe the qualification and the potential impact on the results),]* the contractor has submitted data that *[, although not adequate in part (see comments on page __, note __),]* are acceptable for negotiating the cost impact due to the unilateral change. We have determined that the unilateral change will result in increased *[decreased]* cost to the Government on CAS-covered contracts and subcontracts in the aggregate of \$ _____. Since the Government is prohibited from paying such increased costs in accordance with FAR 52.230-2(a)(4)(ii), we recommend that the CFAO take immediate action to recover the aggregate increased costs *[omit this sentence if there are decreased costs]*. Our detailed findings and recommendations are included in Exhibit ____.”

(3) The report on a cost impact proposal for a desirable change could read:

“In our opinion, *[except for the (describe the qualification and the potential impact on the results),]* the contractor has submitted data that *[, although not adequate in part (see comments on page __, note __),]* are acceptable for negotiating the cost impact due to the desirable change. We have determined that the desirable change will result in increased *[decreased]* costs to the Government on CAS-covered contracts and subcontracts in the aggregate of \$ _____. We recommend that the CFAO negotiate an equitable adjustment in accordance with FAR 52.230-2(a)(4)(iii). Our detailed findings and recommendations are included in Exhibit ____.”

(4) The report on a cost impact proposal for a noncompliance could read:

"In our opinion, [except for the (describe the qualification and the potential impact on the results),] the contractor has submitted data that [, although not adequate in part (see comments on page __, note __),] are acceptable for negotiating the cost impact due to the noncompliance. We have determined that the noncompliance will result in increased [decreased] cost to the Government on CAS-covered contracts and subcontracts in the aggregate of \$ _____. Since the Government is prohibited from paying such increased costs in accordance with FAR 52.230-2(a)(5), we recommend that the CFAO take immediate action to recover the aggregate increased costs [omit this sentence if there are decreased costs]. Our detailed findings and recommendations are included in Exhibit ____."

b. Exhibits and Schedules. The Results of Audit section of the report should contain all exhibits and supporting schedules required for a clear and complete presentation of the audit results and recommendations on all items in the cost impact proposal. Clearly define each use of brackets or parentheses in the schedules and exhibits so the reader will understand the implication of each negative number. For example, if cost accumulations will be decreased by a changed accounting practice, state "...a negative number means that fewer costs will be accumulated using the new accounting practice." All exhibits and schedules should clearly distinguish between (i) increased or decreased cost estimates or accumulations, including associated profit/fee; and (ii) increased or decreased costs to the Government. At a minimum, the report should include the following information:

(1) An exhibit summarizing the contractor's cost impact proposal by contract type, showing the proposed impact on cost, profit/fee, and price/amount; results of audit; and explanatory notes (see Figure 10-8-1). Explanatory notes should include:

(a) Summary of Conclusions. Provide a summary statement of the audit exception(s) and the basis for the exception(s), including a specific reference to the regulatory support in the CAS [for example: 48 CFR 9903.201-4(a)(5) or 48 CFR 9903.306(c)]. The following table and related statements are recommended tools for the auditor to use in preparing the Summary of Conclusions. The table explains the effect of the contractor's cost accounting practice change or noncompliance on contract prices (costs and profits or fees) paid by the Government. This table should not be included in the audit report. Use the table by reading down and across under the appropriate categories of cost impacts. The numbers in each box correspond to the sentences that follow the table. Use these sentences in the order shown in the table to explain the effects of cost accounting practice changes and noncompliances on each type of contract.

Contract Type	Estimating Noncompliance	Accumulation Noncompliance	Cost Accounting Practice Changes	Estimating and Accumulation Noncompliance
Flexibly Priced:				
CPFF	1, 11	2, 12	2, 11	2, 11
CPAF	1, 13	2, 13	2, 13	2, 13
CPIF	1, 14	2, 15	2, 15	2, 16
FPI	1, 14	2, 15	2, 15	2, 16
T&M Materials	6, 17	7, 17	7, 17	7, 17
Fixed Price				
FFP	3, 11	4, 12	5, 11	3, 11
T&M Labor Rates	8, 11	9, 12	10, 11	8, 11

1. Cost estimates prepared by the contractor using noncompliant practices do not affect costs paid by the Government on flexibly priced contracts and subcontracts.
2. Costs paid by the Government on flexibly priced contracts and subcontracts are based on accumulated costs, not cost estimates. When cost accounting practice changes or CAS noncompliances increase/(decrease) cost accumulations during performance of flexibly priced contracts and subcontracts, the Government pays increased/(decreased) costs.
3. Cost estimates prepared by the contractor using noncompliant practices affect the costs paid by the Government on fixed-price contracts and subcontracts. The Government experiences increased costs (pays a higher price) when estimates are overstated due to the use of noncompliant practices. Conversely, the Government experiences decreased costs (pays a lower price) when estimates are understated due to the use of noncompliant practices.
4. CAS noncompliances in cost accumulation during contract performance do not affect costs paid by the Government on fixed-price contracts and subcontracts.
5. Cost accounting practice changes during contract performance affect costs paid by the Government on firm-fixed-price contracts and subcontracts.
6. Material cost estimates prepared by the contractor using noncompliant estimating practices do not affect costs paid by the Government on time and materials (T&M) contracts and subcontracts.
7. The Government pays for materials on time and materials (T&M) contracts and subcontracts based on actual material costs incurred, not estimated material costs. When cost accounting practice changes or CAS noncompliances increase or decrease material costs accumulated during contract performance of T&M contracts and subcontracts, the Government pays increased or decreased costs.
8. Labor rate estimates prepared by the contractor using noncompliant estimating practices affect the costs paid by the Government on time and materials (T&M) contracts and subcontracts. The Government experiences increased costs (pays a higher price) when estimated labor rates are overstated due to the use of noncompliant practices. Conversely, the Government experiences decreased costs (pays a lower price) when estimated rates are understated due to the use of noncompliant practices.
9. CAS noncompliances in cost accumulation during contract performance do not affect labor rates on time and materials (T&M) contracts and subcontracts.
10. Cost accounting practice changes during contract performance affect labor rates on time and materials (T&M) contracts and subcontracts.

11. Profit and fixed fees are generally based on estimated costs and are affected by cost estimates that are prepared using noncompliant practices and cost accounting practice changes during contract performance.

12. Profit and fixed fees are generally based on estimated costs and are not affected by CAS noncompliances in cost accumulation during contract performance.

13. Award fees are generally based on factors other than contract costs and, therefore, are not affected by cost accounting practice changes or CAS noncompliances.

14. Incentive fees are generally used to reward the contractor's ability to manage estimated (target) contract costs and are based on both estimated and accumulated costs. When costs are estimated using noncompliant practices, increases/decreases to the cost estimates affect incentive fees paid by the Government.

15. Incentive fees are generally used to reward the contractor's ability to manage estimated (target) contract costs and are based on both estimated and accumulated costs. Cost accounting practice changes and accumulation noncompliances during contract performance affect the cost accumulations and incentive fees paid by the Government.

16. Incentive fees are generally used to reward the contractor's ability to manage estimated (target) contract costs and are based on both estimated and accumulated costs. Noncompliant practices used for both estimating and accumulating costs affect incentive fees in opposite ways.

17. Profit and fees are not permitted on materials under T&M contracts in accordance with FAR 16.601(a).

(b) Basis of Contractor's Proposal. Describe the basis of the contractor's cost impact proposal, including comments on the netting methodology among contract types used by the contractor. When appropriate, provide references to the specific parts of the contractor's proposal that provide more details on the basis.

(c) Audit Evaluation. Provide a description of the audit procedures used to evaluate the elements of the cost impact proposal (costs and profit/fee). Include sufficient detail on the calculation of the audit exceptions for the CFAO to understand the basis for the audit exceptions.

(d) Contractor's Reaction. Provide a statement that the contractor either agreed or disagreed with the auditor's conclusions, and the basis for any disagreement.

(e) Auditor's Response. Provide appropriate comments if the contractor disagrees with the auditor's conclusions.

(2) A schedule showing results of audit by agency, contract type and significant contracts (see Figure 10-8-2).

c. Additional Remarks. Provide concluding remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. That summary might read as follows:

"We discussed the results of our examination with [identify the contractor representative(s) by name and title] in an exit conference held on [date]. [If there were adverse findings] In response to our findings, [provide the contractor's reaction, if any.] [If there was no response, the following is an example of a statement that is permissible but not required. (Identify the contractor representative) reserved comment pending discussions with the cognizant Federal agency official.]"

d. Include an appendix describing the settlement alternatives to recover increased costs paid by the Government in the aggregate, as described in 8-503.1e, providing specific recommendations for settlement and offering assistance to the CFAO in determining the appropriate settlement alternative.

10-809.6 Contractor Organization and Systems

Use this section to provide supplementary information on the contractor's operations and systems necessary for a better understanding of the circumstances surrounding the auditor's recommendation. Refer to 10-210.7 for general guidance on preparing this section.

10-809.7 Report Distribution and Restrictions – CAS Cost Impact

Refer to the guidance in 10-810 for report distribution and release restrictions.

10-810 Distribution and Restrictions

- a. Furnish copies of CAS audit reports to non-DoD agencies as noted in 15-100 and Supplements 15-1S1-15-1S6.
- b. Furnish the CAC/CHOA/GAC copies of all CAS audit reports as provided in 15-200.
- c. Furnish the region copies of CAS audit reports, following the procedures established by the region.
- d. Refer to the guidance provided in 10-212 for general requirements for the report distribution and release restrictions.

Figure 10-8-1
Statement of Contractor's Proposed
Contract Price Adjustments
and Results of Audit

CONTRACT/ SUBCONTRACT TYPE	CONTRACTOR'S PROPOSAL			RESULTS OF AUDIT			REFERENCE
	COST	PROFIT/ FEE	PRICE AMOUNT	INCREASED/ (DECREASED) ACCUMULATED COST/ ESTIMATES	INCREASED/ (DECREASED) PROFIT/FEE	INCREASED/ (DECREASED) COST PAID BY THE GOVERNMENT	
Flexibly Priced							
CPFF							
CPAF							
CPIF							
FPI							
T&M Material							
Fixed Price							
FFP							
T&M Labor Rates							
Total							

Figure 10-8-2
Statement of Audit Recommended Increased/(Decreased) Cost to the Government by Agency, Contract Type and Major Contract

	RESULTS OF AUDIT				
CONTRACT/ SUBCONTRACT TYPE	U.S. ARMY	U.S. NAVY	U.S.AIR FORCE	NASA	OTHER AGENCIES
FLEXIBLY PRICED					
CPFF					
CPAF					
CPIF					
FPI					
T&M Materials					
FIXED PRICE					
FFP					
T&M Labor Rates					
TOTAL					

10-900 Section 9 --- Audit Reports on Contract Audit Closing Statements, Other Contract Closings, and Price Redeterminations

10-901 Introduction

- a. This section provides guidance for the preparation and distribution of:
 - contract audit closing statements (CACS) on cost reimbursement and time and material type contracts and subcontracts, whether issued as a written report or an electronic data transmission; and
 - repricing proposals for incentive and price redeterminable fixed-price contracts.
- b. Guidance involving requests for contract audit closing statements for non-DoD agencies is in 15-103. Guidance on assist reports to other contract auditors is in 6-800. Further guidance concerning processing completion vouchers is in 6-1000.
- c. Generally, contract closeout audits are administrative in nature. The audit work performed and opinion on the allowable contract costs are contained in the annual audit of the contractor's incurred costs. If these audits have not yet been performed, the contract generally cannot be closed out unless the periods unaudited qualify for quick-closeout as discussed in 6-1010.
- d. A single audit report may be issued on each contract or on a group of contracts. If a single audit report is issued on more than one contract, coordinate with the contracting officer on needed report information prior to issuing the report. If available, use the Cumulative Allowable Cost Worksheet (CACWS), or a comparable worksheet, as the source for the information to complete the Contract Audit Closing Statement (CACS). In most instances, the CACWS should be acceptable to the ACO to close contracts without the need for a traditional CACS (see 6-711.3).

10-902 Cumulative Allowable Cost Worksheet (CACWS), Comparable Worksheets, or Contract Audit Closing Statement Reports (CACS)

Completed contracts should be closed by one of these methods (in order of preference):

- (1) issuing a CACWS (see 6-711.3) without a traditional final written CACS report, if acceptable to the ACO;
- (2) issuing one closing audit report for multiple contracts; or
- (3) issuing an audit closing statement for each contract.

a. The contract audit closing statement or CACWS is usually the final report to be submitted upon completion or termination of a cost-reimbursement or time and material type contract or subcontract.

b. Some contracts have numerous task orders, sub-line items, or other separate portions that are separately funded. If the customer agrees, it is frequently more efficient to issue a single contract audit closing statement or CACWS with a listing of cost data by separate task order, line item or funding provisions. This is an acceptable alternative to issuing a separate report for each task order or line item number. Such a consolidated report must provide all pertinent information for each task order or line item number being closed.

c. Generally, the contract audit closing statement contains the following sections:

- Cover Sheet
- Subject of Audit
- Scope of Audit
- Results of Audit
- DCAA Personnel and Report Authorization
- Audit Report Distribution and Restrictions.

The "shell" report and the audit program are available on the Audit Planning and Performance System (APPS) and the DCAA Intranet. Some additional considerations for the Scope of Audit and the Results of Audit sections are presented below.

d. Subject of Audit. The purpose of the audit is to verify the contractor's assertion that costs claimed represent allowable costs and fee for the contract. Briefly state information which is pertinent to the closing of the contract such as contract number, final voucher number, dollar amount of contract, description of work performed, and the period of contract performance.

e. Scope of Audit. Generally, the traditional scope paragraph (see 10-210.3) is appropriate. The following information or pertinent comments should be provided in the "Qualifications" paragraph when significant and appropriate.

(1) A brief statement should be made of any deficiencies in the contractor's accounting procedures, with the auditor's recommendations for corrective actions. (Note that such deficiencies should be identified as qualifications only when the cost impact cannot be determined. If the impact can be determined, the deficiency would be reported in the Results of Audit section of the report.) This is necessary only where the contractor has other continuing auditable contracts or is expected to be awarded such contracts in the near future.

(2) When the cost impact cannot be determined, provide a statement of status of any unsettled disapprovals, outstanding subcontract legal actions, open insurance claims, or other unresolved items of which the auditor has knowledge. When the cost impact is known, this statement belongs in the Results of Audit section of the report.

(3) When quick-closeout procedures are being used, make a brief statement that the audit was performed in response to (a) the contractor's request for final payment, or (b) the contracting officer's request for assistance in closing out the contract (subcontract) using administrative quick-closeout procedures under FAR 42.708. This should be followed by statements on what fiscal years have been audited and which have not been audited. See 10-903 for suggested wording.

f. Results of Audit. The audit results should begin with the phrase, "In our opinion, [except for the (describe the qualification and the potential impact on the results)], . . ." and should comment on the following items:

(1) The overall allowability of the costs claimed by the contractor (when applicable, also comment on allowability regarding particular contract terms on cost such as task/delivery order limitations, ceiling rates, not to exceed costs, or other special cost provisions within the contract);

(2) Any contractor operations pertinent to cost sharing affecting final settlement of the contract;

(3) The impact of appropriate Qualifications;

(4) Any unclaimed wages, unclaimed deposits, unrepresented checks, and potential credits and refunds.

(5) If Government funds were advanced to finance the contractor's operations, a statement should be made of the unliquidated balance of the advance, after all adjustments and any unpaid interest charges on such funds or contractor's failure to replace funds expended for disapproved expenditures.

(6) When the work contemplated by the contract has not been physically completed, the auditor should comment upon this situation so that the contracting officer may determine whether an adjustment should be made in the fixed fee payable under the contract.

(7) When Government furnished material or equipment is furnished to the contractor in amounts greater than contemplated by the terms of the contract, thereby relieving the contractor of the responsibility of furnishing the items, the matter should be commented on, in order that the contracting officer may determine whether the contractor is entitled to the stipulated fee. Additionally, if the contract provides for cost-sharing or participation by the contractor in cost savings, the auditor should indicate that part of the cost savings resulting from this factor.

(8) If an exit conference was conducted, follow the guidelines presented in 10-210.5e. If an exit conference was not conducted, include a statement explaining the circumstances. For example, a statement might read:

"An exit conference was not conducted because [provide reason.]"

10-903 Quick-Closeout Procedure Reports

The auditor should issue a contract audit closing statement when (i) a contractor requests final payment on a contract meeting the criteria for quick-closeout under FAR 42.708 (also see 6-1010) and (ii) the contracting officer requests DCAA's advice regarding the final payment and use of quick-closeout procedures. This is an application of agreed-upon procedures; follow the guidance in 10-1000 as supplemented in the following paragraphs.

When preparing the closing statement in this situation, the report will clearly indicate what costs and fiscal periods have been audited and which have not been audited. Suggested wording for the "Scope" paragraph follows:

"This application of agreed-upon procedures is in response to your request for assistance in closing out the contract using the administrative quick-close out procedures under FAR 42.708. The costs of \$___ claimed on the subject contract represent costs recorded for the contract during FYs 20X2-20X4. Of this amount, \$___ represents amounts incurred during FYs 20X2-20X3. We have completed the annual audits of incurred cost for these years. The remaining claimed costs of \$___ were recorded during FY 20X4. The audit of [contractor's name] FY 20X4 incurred costs is in process. We do not expect that the FY 20X4 audit results will find a significant exception to the claimed costs."

10-904 Repricing Proposal Reports for Incentive and Redeterminable Fixed-Price Contracts

a. The audits of incurred costs under repricing proposals for incentive (FAR 16.403) and redeterminable (FAR 16.205) fixed-price contracts are similar to other contract closeout audits, therefore, a similar closeout report is generally appropriate.

b. Because of the nature of such contracts, (cost/performance incentives and/or prospective/retroactive redetermination) the auditor should coordinate with contracting officials early -- to plan the audit and the report -- to be responsive to customer needs. In cases where the contract provides for an incentive fee based in part upon performance or quality, coordination is essential to obtain technical information to determine the contract fee.

c. The Scope of Audit section should address the applicable Qualifications listed above (10-902e.), as well as any pertinent qualifications involving incentive fee and profit computations.

d. The Results of Audit section would be generally consistent with the guidance above (10-902f.) and include a specific recommendation on incentive fee and profit computation. Other pertinent comments might include:

- Cost sharing provisions
- Outstanding Form 1s
- Warranty clauses
- Make or Buy decisions
- Subcontracts -- cost pyramiding
- Contractor overpayments

10-905 Report Distribution – CACS and Repricings

a. Contract audit closing statement shall be distributed as follows:

(1) Closing statements other than in (2) through (6) below will be submitted to the administrative contracting officer.

(2) Closing statements for terminated contracts will be submitted to the termination contracting officer. The closing statement should be issued no later than the submission date of the advisory audit report on the contractor's termination settlement proposal.

(3) Closing statements related to NASA contracts will be sent to the cognizant contracting officer. If requested by NASA IG, furnish a copy to the NASA Office of Inspector General, Assistant IG for Auditing. (See Supplement 15-1S1.)

(4) For the Department of Health and Human Services (DHHS), closing statements will be submitted to the DHHS Inspector General office that requested the audit (See 15-1S3).

(5) Reports issued on AID contracts should be addressed to:

Office of Inspector General
U. S. Agency for International Development
Director, Financial Audit Division
1300 Pennsylvania Avenue, NW
OIG/A/FA, Room 8.10-001
Washington, DC 20523-7802
e-mail: faudit@usaid.gov

Also see (see 13-706.4) and 13-706-7).

(6) Reports related to National Guard Bureau contracts will be issued to the United States Property & Fiscal Officer (USP&FO) designated as the contracting officer (14-903.5).

b. Where the completion voucher and related closing documents (original and six copies) have not been previously submitted to the ACO/TCO, they should be forwarded by transmittal memorandum at the conclusion of the closing statement, but not as part of the closing statement. This will expedite electronic transmission of the closing statement.

c. Reports for repricing proposals will be submitted to the requesting ACO/PCO and other appropriate recipients.

d. All report recipients will be identified in the Distribution section of the report.

10-1000 Section 10 --- Reports on Application of Agreed-Upon Procedures

10-1001 Introduction (Agreed - Upon Procedures)

This section provides guidance for preparing application of agreed-upon procedures reports. An agreed-upon procedures engagement is one in which an auditor is requested to issue a report of findings based on specific procedures performed on an assertion or a subject matter. Generally Accepted Government Auditing Standards incorporate Statements on Standards for Attestation Engagements (SSAE) guidance covering fieldwork and reporting on applications of agreed-upon procedures.

10-1002 Nature of Reports (Agreed - Upon Procedures)

a. DCAA is authorized to accept agreed-upon procedures engagement requests for any attestation assignment if (1) the subject matter to which the procedures are to be applied is subject to reasonable and consistent measurement, (2) the requestor and DCAA agree as to the nature, timing, and extent of the procedures to be applied, and (3) the requestor assumes responsibility for the sufficiency of the procedures.

b. Auditing standards require that the auditor establish a clear understanding regarding the work to be performed. DCAA auditors should accomplish this through an acknowledgment letter (see 4-103d.) tailored to the specific procedures agreed upon for the assignment. If the initial request is unclear, the acknowledgment letter should not be issued until after DCAA and the requestor have discussed the requirements and have reached an understanding of the procedures to be applied. The auditor should determine the requestor's objectives and then discuss the procedures which will assist the requestor in accomplishing their objectives. If applicable, the auditor and requestor should also explicitly discuss the use of a technical specialist. The auditor should document the discussion. The auditor should not report on an agreed-upon procedures engagement when the auditor and requestor do not agree upon the procedures to be performed or when the requestor does not take responsibility for the sufficiency of the procedures.

c. An agreed-upon procedures engagement is appropriate for situations where the requestor wants information on a subject matter or assertion. Agreed-upon procedure engagements are not appropriate when the requestor requires the auditor to express an opinion or provide recommendations. Examples of agreed-upon procedure engagements that DCAA may perform are:

- Tracing of claimed costs on interim vouchers to the contractor's books and records,
- Compliance with specified requirements based on procedures agreed upon by the requestor of the report, including compliance evaluations for the Defense Security Cooperation Agency (see 14-908), and
- Evaluations of Other Transactions Agreements (see 14-909).

10-1003 Report Format and Contents (Agreed - Upon Procedures)

a. In an agreed-upon procedures engagement, an auditor is asked by a requestor to issue a written report covering all findings arising from the application of clearly identified procedures performed on the contractor's subject matter or assertions, such as claims or other submittals, documents, or records. The concept of materiality does not apply to findings to be reported in an agreed-upon procedures engagement unless the definition of materiality is agreed to by the auditor and requestor. Therefore, all findings must be reported, even if immaterial.

b. Prepare reports following the standard aspects of report preparation (see 10-200) and the professional standards for reporting (see 2-400). The auditor will also be guided by the reporting concepts for the assignment types discussed in 10-400 through 10-1200

and the information below. The report should contain all necessary and pertinent information to be fully responsive to the needs of the recipient.

c. Reports should be prepared using the following format:

Cover Sheet

Report Narrative

Subject of Application of Agreed-Upon Procedures

Executive Summary

Scope of Application of Agreed-Upon Procedures

Description of any Agreed-Upon Materiality Limits (if applicable)

Description of the Nature of Technical Assistance Provided (if applicable)

Restrictions on Procedures

Results of Application of Agreed-Upon Procedures

Disclaimer of Opinion

Exhibits and Schedules

Additional Remarks

Contractor Organization and Systems

DCAA Personnel and Report Authorization

Report Distribution and Restrictions

Appendixes, if needed.

10-1004 Report Narrative (Agreed - Upon Procedures)

a. An application of agreed-upon procedures does not constitute an examination or a review. However, it is more than merely providing specific cost information. Our report assists the requestor in evaluating a subject matter or assertion. An agreed-upon procedure report compares the specified subject matter or assertion against agreed-upon criteria. The requestor selects these criteria to achieve an intended purpose. The report number, the report title, the section headings, and the report header are revised to delete the word "Audit." Include the words "Application of Agreed-Upon Procedures" in the section headings. The separate report sections should be tailored to describe the agreed-upon procedures performed. The use of the term "engagement" is more appropriate to describe the work performed by DCAA. The engagement should be described in terms of applying specified procedures, rather than using the term "audit" or terms reserved for attestations, such as "examination" or "review." Avoid generic terms such as review, check, or test unless the acknowledgement letter specifically states the extent of the testing and the objectives to be accomplished. Examples of inappropriate and appropriate procedures are listed below.

Inappropriate Procedures	Appropriate Procedures	Why it is inappropriate
We checked inventory balances.	We matched receiving reports to inventory records.	Did you count and verify quantities? Verify prices? Recalculate and foot the extensions?
We tested claimed travel costs.	We selected a statistical sample of travel vouchers and identified all premium airfare costs.	How did you test them? What was the scope of the procedures?
We reviewed/examined claimed material items.	We selected the 5 highest dollar material items and compared amounts claimed to vendor invoices.	The words review and examine imply that an opinion or negative assurance is given. What did you do with the information found?
We evaluated the pro-	We calculated the actual	Evaluated to what criteria?

posed overhead rate.	1999 overhead rate incurred using XYZ's trial balance, dated 12/31/99, and compared the resultant rate to the rate proposed.	
We read the contractor's timekeeping policies and procedures to determine adequacy.	We determined if the contractor's policies and procedures require work authorizations to be issued independently of employees performing the work.	Merely reading a document is insufficient. What procedures did you perform? The word adequacy implies auditor judgment.

Likewise, the results of the agreed-upon procedures should be expressed in terms of findings rather than "adjustments," "recommendations," or "questioned cost." Examination report type language, such as "in our opinion," or "nothing came to our attention" should not be used to describe findings. Findings should be presented as factual statements.

b. Generally accepted government auditing standards incorporate the AICPA's attestation standards, including standards for applications of agreed-upon procedures. The agreed-upon procedures engagement is not considered an examination because of the limitations on the audit scope (see 2-104d.). The Results of Application of Agreed-Upon Procedures section will begin by disclaiming an opinion on the assertion or subject matter. The body of the narrative will state each procedure and all related findings. The auditor is not required to perform additional procedures beyond those agreed to. It is the requestor's responsibility to determine the agreed-upon procedures to be performed. However, the auditor should inform the requestor of any known system deficiencies, internal control deficiencies, or CAS or FAR violations which might significantly affect the objective of the agreed-upon procedures. Such discussions should be documented in the working paper file, reiterated in the acknowledgment letter, and explained in the "Other Matters to Be Reported" section of the report.

c. The report will provide neither positive assurance regarding any contractor representations nor negative assurance that nothing came to DCAA's attention that caused us to believe that the assertion is not fairly stated. Reporting standards for attestation audits require application of agreed-upon procedure reports to include a statement, such as "had we performed additional procedures, other matters might have come to our attention that would have been reported to you." This statement does not constitute negative assurance.

10-1005 Subject of Application of Agreed - Upon Procedures

The subject paragraph, modified for the application of agreed-upon procedures, may read:

"As requested by [*requestor organization name*] in a memorandum dated [*date*], reference [*requestor's reference number*], and as discussed subsequently with your office, we applied agreed-upon procedures to the [*subject matter or contractor assertion*] of [*contractor name*] for contractor fiscal years 19[XX] through 20[XX]. The purpose of our engagement was to. . ."

When the auditor participated as a member of an IPT, the subject paragraph should include the following statement:

"As requested by [*requestor organization name*] in a memorandum dated [*date*], reference [*requestor's reference number*], and as discussed subsequently with your office, we applied agreed-upon procedures to the [*subject matter or contrac-*

tor assertion] of [*contractor name*]. The contracting officer formed an Integrated Product Team (IPT) to effectively and efficiently manage the subject acquisition. At the request of the contracting officer, as part of the agreed-upon procedures accomplished, DCAA participated as a member of the IPT.”

[Note that the second paragraph regarding responsibility is omitted (see 10-210.1) because an audit is not being performed.]

10-1006 Executive Summary

Due to the limited nature of the agreed-upon procedures, this section usually is not needed. However, an Executive Summary should be used if it is necessary to direct the user’s attention to significant adverse findings addressed in the report.

10-1007 Scope of Application of Agreed - Upon Procedures

a. An agreed-upon procedures engagement is designed to accommodate the specific needs of the parties in interest. The statement of scope must identify the procedures agreed upon between DCAA and the requestor, including a description on any agreed-upon materiality limits.

b. In “examinations” and “reviews,” the criteria against which assertions are evaluated are generally GAAP, FAR/DFARS, and CAS. When these criteria apply to agreed-upon procedures engagements, they should be set out in the scope paragraph. It is possible that additional criteria may also apply. Other regulatory guidance, statutes, and agreements between the Government and contractor, which were used as criteria against which an assertion was evaluated, should be referenced here. These would include OMB Circulars at educational and nonprofit organizations, statutes when rendering investigations support, ACO advance agreements, memoranda of agreement, etc.

c. Begin the scope paragraph with the following statement to make clear that the engagement was limited to agreed-upon procedures.

“We have performed the mutually agreed-upon procedures enumerated below solely to assist you in evaluating [*subject matter or contractor assertion*]. This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards. The sufficiency of the procedures is solely the responsibility of the requestor. Consequently, DCAA makes no representation regarding the sufficiency of the procedures described below, either for the purpose for which this report has been requested or for any other purpose.”
[Note that the traditional scope paragraphs regarding evaluation criteria and control risk are omitted because an examination is not being performed.]

d. List the specific procedures performed. For example, the listing may read:

“The following agreed-upon procedures were applied:

[List only the procedures agreed-upon for the application being reported].

- briefed contract DABT10-92-D-0123 to identify any special provisions/limitations specified in the contract;
- compared severance pay calculations with the contractor’s established policy for calculating severance pay;
- reconciled direct costs billed to the general ledger;
- verified billed labor hours to the labor distribution;
- verified billed labor rates to contract terms; and
- inspected labor code E-3 cost transfers for COTR approval.”

10-1008 Restrictions on Procedures

The Restrictions on Procedures section is similar to the scope qualification in audit reports. However, a qualification section is not used in agreed-upon procedures engagements because the auditor disclaims an opinion. Therefore, qualifications, such as time limitations, inadequate systems, or instances of non-compliance with FAR and CAS are generally not appropriate. Restriction on procedures applies only to the inability to perform agreed-upon procedures. When circumstances impose restrictions on the performance of the agreed-upon procedures, the auditor should attempt to obtain agreement from the requestor for modification of the agreed-upon procedures. If an agreement cannot be reached, the auditor should describe the reportable restrictions in the report or withdraw from the engagement if the omitted procedure significantly impacts the extent of the procedures.

10-1009 Results of Application of Agreed - Upon Procedures

This section communicates (1) a disclaimer of opinion; (2) the findings of the agreed-upon procedures performed, and (3) additional remarks, as applicable in the circumstances.

a. Disclaimer of Opinion: Start with a statement that an audit was not performed, a disclaimer of opinion, and a statement that if additional procedures had been performed, other matters might have come to our attention that would have been reported. When the application of agreed-upon procedures discloses significant deficiencies, such as inadequate cost or pricing data, internal control deficiencies, and/or significant non-compliances with FAR or CAS, identify the location in the report that discusses the significant deficiency (i.e. "Other Matters to be Reported.") A deficiency that the auditor believes should be called to the user's attention, although it is unrelated to a specific agreed-upon procedure, such as inadequate cost or pricing data or internal control deficiencies, may be reported in an appendix. Only a disclaimer of opinion may be rendered in an application of agreed-upon procedure report.

(1) An example of a disclaimer of opinion, which might be used when the application of procedures to assist the requestor in the evaluation of information, other than cost or pricing data, disclosed no findings and no noncompliances with FAR or CAS, follows:

"This report pertains only to the performance of agreed-upon procedures to assist you in the evaluation of [*briefly specify the subject matter or assertions covered by the engagement*]. We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you."

(2) An example of a disclaimer of opinion which might be used when the application of the procedures to assist the requestor in the evaluation of information, other than cost or pricing data, disclosed noncompliances with FAR or CAS, follows:

"This report pertains only to the performance of agreed-upon procedures to assist you in the evaluation of [*briefly specify the subject matter or assertions covered by the engagement*]. We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. As stated in [*report number, date, and subject of report*], the contractor's accounting system does not accumulate data necessary for the evaluation of labor transfers. Had we

performed additional procedures, other matters might have come to our attention that would have been reported to you.”

b. Exhibits and Schedules: The next part of the “Results” section should describe the contractor books and records to which agreed-upon procedures were applied. The results should be presented in an exhibit type format that identifies or references the procedures performed with the related findings. Appropriate explanatory notes should be provided. While exhibits and explanatory notes in agreed-upon procedure reports are usually not as extensive as those in audit reports, the general guidelines for preparation of exhibits and notes (see 10-210.5), and in the applicable audit area (see 10-300 through 10-1200), may be used as a reference. The goal is to clearly and concisely explain the findings to the requestor.

c. Other Matters to be Reported: Matters that significantly impact or contradict the subject matter or assertion being reported on, that come to the auditor’s attention by means of application of the agreed-upon procedures or other than the application of the agreed-upon procedures, should be communicated to the requestor. For example, if, during the course of applying agreed-upon procedures regarding a contractor’s proposed direct labor rates, a flash report is issued disclosing significant internal control deficiencies in the contractor’s estimating system, the auditor should include this matter in the report. However, unless specifically requested to do so, the auditor is not obligated to perform additional procedures beyond those agreed to.

d. Additional remarks: Indicate the date an exit conference was held and the name and title of the contractor’s designated representative with whom the exit conference was conducted (see 4-304). Also, briefly describe the contractor’s reaction in this section. Where appropriate, detailed comments on the contractor’s reaction to the report findings will be included in the explanatory notes. When the contractor provides a formal, written response, it should be referenced within the Results of Application of Agreed-Upon Procedures section and included as an appendix to the report. Further remarks should be included when appropriate to the circumstances. For example, include remarks if information in the report was provided to the contracting officer in advance by telephone or if significant internal control deficiencies relevant to the elements being reported on have been previously identified and reported, but not yet resolved.

10-1010 Contractor Organization and Systems

Follow the general guidelines (see 10-210.7) to prepare comments regarding the contractor organization and systems section of the report.

10-1011 Report Distribution and Restrictions (Agreed - Upon Procedures)

Restrictions paragraph 4 should be revised as follows:

“This report was prepared using procedures agreed upon by the identified requestor. The reported findings do not include an audit opinion. The information contained in this report is intended solely for the use of the identified recipients, and should not be used by them or by others for any purpose other than that for which the procedures were established.”

10-1100 Section 11 --- Audit Reports on Price Adjustment Proposals or Claims**10-1101 Introduction (Claim Reports)**

a. This section provides guidance for preparing reports on price adjustment proposals or claims. For additional significant report requirements on price adjustment proposals and claims, refer to 12-800.

b. A requestor may ask DCAA to evaluate limited portions of contractor price adjustment proposals or claims by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of price adjustment reports. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an “examination” or a “review;”
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

c. Because of the sensitivity of a claim and the possibility that it will become the subject of litigation, it is unlikely that a requestor will want to limit the evaluation to a review. However, the evaluation of a claim may be performed as a review if necessary to meet time constraints or other special needs of the requestor. Modify the subject, scope and opinion paragraphs as shown in 10-210.

d. While it is possible to evaluate a portion of a claim using the standards for an audit, either an examination or a review, it may be inadvisable to do so. The elements of the claim may be highly interconnected. Should the FAO receive a request for an audit of part of a claim, the specific issues to be addressed should be analyzed, and a determination made as to whether the elements covered by the request may be evaluated on a stand-alone basis. The analysis should be documented in the working papers.

10-1102 Proper Terms (Claim Reports)

a. For price adjustment proposals, incorporate in the resulting audit report the terms “negotiation” and “Truth in Negotiations Act” as if the submission were a price proposal (a pricing action). Since a claim is no longer considered a pricing action, the appropriate terms cited in these cases are “adjudication” or “settlement” versus “negotiation.” Refer to the correct type of submission; e.g. a price adjustment proposal or a claim, when the submission meets the requirements of FAR 33.201. Refer to 12-504 for further guidance.

b. Some pro forma comments used in price proposal reports are not suitable for claim reports. When the audit concerns a claim being appealed to the ASBCA or courts, do not refer to pricing terms that apply to expected negotiations. In particular, question costs for lack of support rather than classifying them as unsupported, because claim audits generally deal with after-the-fact costs. Also, do not refer to 10 U.S.C. 2306a on claims required to be certified by the Contract Disputes Act of 1978 (use 41 U.S.C. 601).

10-1103 Report Format and Contents (Claim Reports)

a. Since claims often involve legal issues and frequently are complex, the audit report must be sufficiently clear, complete and accurate to withstand the rigors of the appeal process.

b. The nature and extent of detail in the report depends on:

- (1) the complexity of the proposal or claim,
- (2) the significance of errors or omissions,
- (3) the materiality of the auditor's recommended adjustments,
- (4) results of discussions with the contractor, and

(5) the contracting officer's specific requests.

c. The minimum data requirements stated in 10-1105.1 apply, even if the audit did not result in questions regarding the contractor's submitted costs or other qualitative or quantitative aspects. Also include in the report the information stated in 10-1104, regardless of the audit findings.

10-1103.1 General Format

Prepare the report following the guidance in 10-100 and 10-200, as supplemented by this section. The general arrangement of report contents follows:

Audit Report Cover Sheet (10-205)

Report Narrative (10-210)

Subject of Audit (10-1104.1)

Executive Summary (10-1104.2)

Scope of Audit (10-1104.3)

Qualifications (10-1104.4)

Results of Audit (10-1105)

Opinion (10-304.6)

Exhibits and Schedules (10-1105.1)

Unsatisfactory Conditions and/or Other Audit Recommendations (4-800)

Additional Remarks (10-1105.3)

Contractor Organization and Systems (10-1106)

DCAA Personnel and Report Authorization (10-211)

Report Distribution and Restrictions (10-212)

Appendixes (10-1107)

Following the general format in 10-205, include the title "Report on Price Adjustment Proposal" or "Report on Price Adjustment Claim" on the subject line. Also include the prime contract number on the reference line; and the contractor's name, city, and state on the contractor line.

10-1103.2 Addressing and Distributing Reports

The general policy for addressing audit reports is stated in 10-206; for report distribution, in 10-212. For all reports covered by this section, include the onsite FLA (refer to the FLA Locator on the DCAA Intranet site) in the distribution. Follow the guidance in 10-212.2 on the release of draft audit reports to the contractor. For reports on those claims appealed to a BCA or court, coordinate the release of the report with the Government trial attorney.

10-1104 Report Narrative

The body of the report will contain the following paragraphs, as applicable. (See 10-210 for paragraph format.)

10-1104.1 Subject of Audit

The first paragraph under this heading should identify the type of submission and purpose of the audit. It should state the contract type, incentive provisions, total value of the submission, and whether the submission represents a price adjustment proposal, or a claim under the Contract Disputes Act of 1978. Also include a statement that the submission is the responsibility of the contractor and that the auditor's responsibility is to express an opinion based on the audit [see 10-210.1b.(1)]. Add other appropriate information as necessary.

10-1104.2 Executive Summary

This section is intended to give the reader a brief overview of the audit findings -- audit opinion, recommendations and the significant issues supporting the opinion. Follow the guidelines presented in 10-210.2 and 10-304.2.

10-1104.3 Scope of Audit

a. Include the following scope of audit statement as a separate paragraph, modified as shown where appropriate. This section should also be used to provide information regarding advance agreements and special contract provisions having a bearing on the proposal or claim.

"Except for the qualification(s) discussed below, [omit if there is no "Qualification(s)" section within the "Scope" paragraph], we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the price adjustment proposal (*claim*) is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the price adjustment proposal (*claim*);
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall price adjustment proposal (*claim*) presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a Government technical evaluation*]."

b. The next paragraph should identify the established or stated criteria used to evaluate the proposal or claim. (See 10-210.3d.). For contractors with CAS covered contracts, if the subject contract is exempt from CAS for any of the reasons identified in 48 CFR 9903.201-1, state this fact in the report (see 10-210.3e.). For example:

"Contract number XXXX is not covered by Cost Accounting Standards Board rules and regulations because it is a sealed bid contract and is therefore exempt from all CAS requirements under 48 CFR 9903.201-1(b)(1)."

c. The last paragraph in the Scope of Audit section should describe the impact of the current assessment of control risk on the audit scope. (See 10-210.3f.).

10-1104.4 Qualifications

a. Include this section only if qualifying the audit opinion due to limitations related to the stated purpose and scope of audit (see 10-304.4). In such a case, both the "Scope of Audit" and the "Results of Audit" must specifically refer to this section. (Properly explain any unqualified audit conclusions and recommendations in other portions of the report. Do not refer to them in this part of the report.)

b. This section must clearly explain the nature and potential impact of each circumstance that prevents an unqualified opinion, and any steps taken to overcome or mitigate the problem. If applicable, also explain any further action that the auditor will take after issuing the report.

c. For situations involving several circumstances, use separately numbered subparagraphs for each qualification (e.g., contractor's denial of access to records or inadequate contractor cost records).

10-1105 Results of Audit (Claim Reports)

a. This section should begin with the phrase, "In our opinion. . ." and should present the audit opinion (qualified, if appropriate) and refer to applicable exhibits, schedules, and appendices. (See 10-304.5).

b. Reporting standards (see Chapter 2) require an opinion on the adequacy of submitted cost or pricing data and their compliance with FAR and Cost Accounting Standards where such regulations and standards apply. See 10-304.6c for guidance on developing an opinion.

c. Claims or proposals that include significant questioned costs, including costs questioned for lack of support, may warrant an adverse audit opinion (see 10-304.6). Express an adverse opinion when the contractor should take some specific corrective action before the Government can consider the claim or proposal and related material as an adequate basis for adjudication, settlement or negotiation of a price adjustment (see 9-212.3).

10-1105.1 Exhibits and Schedules

a. Use an exhibit to summarize the proposal or claim as part of the results of the audit (see 10-304.7). Include structured notes to give the reader a comprehensive understanding of the basis of the proposal or claim and, if applicable, the reasons for the auditor's use of a different method to determine a price adjustment. Present important dates in an appendix titled "Chronology of Significant Events" (10-1107.1).

b. Results of audit of the Eichleay formula (see 12-805) should be presented in the report exhibit or a structured note, and should include:

- (1) the contractor's computations;
- (2) the audit computations;
- (3) discussion of the basis for the differences by each element of the formula; and
- (4) any audit adjustments to the computed damages.

See 12-806 for further guidance.

10-1105.2 Unsatisfactory Conditions or Other Audit Recommendations

Use this section to report any unsatisfactory conditions or questionable practices relating to the contractor's operations and the contract being audited. Whether the auditor should include a particular condition or practice in this section depends on its significance and the frequency of previous reporting. When the audit of a contractor's or subcontractor's records or information from other sources suggest fraud, other criminal activity, or the existence of unsatisfactory conditions, send a referral as provided by 4-700 or 4-800 (whichever is more appropriate in the circumstances).

10-1105.3 Additional Remarks

Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate.

a. Exit Conference (see 10-210.5e.(1) and (2))

(1) In all evaluations, state the date and the name and title of the contractor's designated representative with whom the results of audit and/or the factual matters were discussed (see 4-304).

(2) In addition, if there were findings, summarize the contractor's reaction to the audit results and/or factual matters, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(3) When the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Include any rebuttals in the "Auditor's Response" portion of the explanatory notes. Include the following statement.

"The complete text of the contractor's response appears as Appendix [X]."

(4) If the contractor provided no response, the following is an example of a statement that is permissible but not required.

"[Identify the contractor representative] reserved comment pending discussions with the cognizant Federal agency official."

(5) An illustration of a report paragraph is shown below:

"We discussed the results of audit with [identify the contractor representative(s) by name and title] in an exit conference held on [date]. [If there are projected estimates for future work, do not disclose the audit results on these projections, disclose only factual matters and include the following as the second sentence: During the exit conference we disclosed only factual matters regarding the estimates for future work not completed.] [Include a summary of the audit results and/or factual matters.] In response to our findings [include a summary of the contractor's reaction to the audit results and/or factual matters.] The complete text of the contractor's response appears as Appendix [X]. [Include the auditor's rejoinder to the audit results and discuss the validity of the contractor's response.]"

b. Per 12-507, draft and final audit reports on equitable adjustment claims should not be provided to the contractor unless the contracting officer or Government trial attorney authorizes the release in writing.

c. Indicate in this section that the results of the examination are based on the contracting officer's determination that the submittal is a price adjustment proposal or a CDA claim. Should this determination be changed, suggest that the auditor be notified so that the impact of such a change on the results of the examination can be assessed. See 12-504d. and 12-504e.

d. Use the guidelines provided in 10-210.5e.(2) to prepare other additional remarks.

10-1106 Contractor Organization and Systems (Claim Reports)

Include relevant information, which impacts the scope and the results of the audit. Tailor it to the contractor's size and where possible reference previous reports. Follow the guidelines in 10-210.7.

10-1107 Appendixes (Claim Reports)

Use an appendix only for required supplementary or supporting information, as explained in 10-213. The report body, exhibit, or schedule should refer to any appendix included as part of the report. The following should be used for a report on a price adjustment proposal or claim.

10-1107.1 Chronology of Significant Events (See Figure 10-11-1)

a. Include a chronology of significant events as an appendix in each proposal or claim audit report. This appendix lists the significant events leading up to or having a bearing on the proposal or claim. Its purpose is to ensure that the report's recipient and potential users (such as the ASBCA judge and attorneys) have an understanding of the key issues and events.

b. The chronology should show whether the contractor certified the claim under the Contract Disputes Act, the certification date, whether the contracting officer has made a decision on entitlement, the date and amount of the initial price proposal, the basic contract plus modification amounts, key events regarding contract performance issues, the dates of alleged delays or disruptions, performance dates anticipated at award date, and actual performance dates.

10-1107.2 Contractor's Written Comments

Include as an appendix a copy of the contractor's written comments submitted in response to the exit conference (see 10-1105.3).

10-1107.3 Observations on Entitlement

Include in an appendix on "other matters" any observations that relate to the contractor's assertion of entitlement (see 12-701 and 12-802.1), such as evidence of delays caused by contractor delays in ordering materials, subcontractor caused delays, or malfunctioning machinery.

Figure 10-11-1 (Ref. 10-1107.1)
Evaluation of Proposal or Claim for Price Adjustment

Audit Report No. _____

APPENDIX 1

EVALUATION OF PROPOSAL OR CLAIM FOR PRICE ADJUSTMENT

Filed under Changes Clause () or Disputes Clause (x)

Contract No. N00999-92-C-1234

Board of Appeals Case No. 33333

Contractor Name XYZ Company

Outside Proposal or Claim Preparer Samuel Jones

Trial Attorney Name Portia Barrister

Date of Initial Price Proposal Aug. 21, 1992 (compet. bid)

Date of Basic Contract September 30, 1992

Contract type Firm-Fixed-Price Competitive

Total Amount of All Modifications \$500,000

Date(s) of Alleged Abnormal Condition(s) October 1, 1992 - January 15, 1994

Description: XYZ Company alleges that the Government provided defective specifications and equipment, which resulted in increased cost.

Contract Specified Performance Dates: From: October 1, 1992 to: September 30, 1993

Actual Performance Dates: From: January 29, 1994 to: September 30, 1996

Telephone (703) 274-7775

Telephone (703) 274-7776

Telephone (202) 514-0832

Amount \$1,000,000

Amount \$1,000,000

CHRONOLOGY OF SIGNIFICANT EVENTS

Event	Date
Contractor alleges defective specifications	
Contractor submits site drawings	Oct. 1, 1992
Contracting officer rejects drawings as nonconforming to contract specifications	March 15, 1993
Contractor protests PCO's actions, requests 180-day delay	March 16, 1993
Contracting officer rejects contractor's request	March 17, 1993
Contractor submits revised drawings	June 27, 1993
Contracting officer approves revised drawings	Aug. 24, 1993
Contractor alleges defective GFE	Nov. 22, 1993
Contracting officer notifies contractor of proposed termination for default	Jan. 10, 1994
Performance begins; TFD withdrawn	Jan. 15, 1994
Contractor submits price adjustment proposal	Jan. 29, 1994
Claim submitted	April 22, 1994
Claim certified under Contract Disputes Act	Aug. 22, 1996
Contracting officer determines contractor is not entitled to a price adjustment and issues final decision	Aug. 22, 1996
Contractor files ASBCA appeal	Aug. 24, 1996
Audit request	Nov. 23, 1996
	Nov. 29, 1996

10-1200 Section 12 --- Reports on Other Areas**10-1201 Introduction (Other Reports)**

a. This section provides guidance for preparing reports on evaluations of an entity's adherence to specific financial compliance requirements such as Earned Value Management System (EVMS) criteria (see 11-200) and other DoD requirements (see 14-800), and contract audit areas not covered in Sections 3 through 11 of this chapter. Reports on other areas should be adapted to the specific audit performed. "Shell" reports for a progress payment audit and a financial capability audit can be found on the DCAA Intranet and the APPS.

b. Pro forma language for review reports has not been developed because it is unlikely that most of the evaluations listed below would be evaluated under the review standards. Additionally, there is some possibility that certain types of reports could be deemed to be determinations of compliance with law or regulation, and if so, they would be ineligible for reporting as a review. Should it become necessary to report results of an evaluation subject to this section as a review and review reporting language has not been furnished in the appropriate "shell" report on the APPS, modify the report to use review reporting language outlined in 10-200. Furnish a copy of the report to Headquarters, Attention PAS.

10-1202 Additional Guidance (Other Reports)

a. The principal audit areas to which the guidance in this section is applicable are listed below. The auditor should refer to the identified section for guidance on performing each type of evaluation, and to 10-212 for general guidance on report distribution.

- (1) Audit Reports Pertaining to Suspected Fraud and Unlawful Activity (see 4-702.5).
- (2) Voluntary Disclosure Program (see 4-707.3).
- (3) Voluntary Refunds (see 4-802.4).
- (4) Contractor Financial Capability Reporting Requirements (see 14-309).
- (5) Progress Payments (see 14-206).
- (6) Contract Funds Status Reports (see 11-305).
- (7) Cost Performance Reports (see 11-305).
- (8) Cost/Schedule Status Reports (see 11-305).
- (9) Contractor Cost Data Reports (see 11-409).
- (10) Contractor Records of Government Property (see 14-408).
- (11) Military Dependents Medical Care Program (see 14-902.3).
- (12) Advance Payments (see 14-904.4).
- (13) Special Audits Related to Government Rights in Inventions (see 14-906.4).
- (14) Special Information Reports for NASA (see 15-106.4).
- (15) Specific information requirements for reports under Agency for International Development contracts (see 15-107 and 13-706.4).
- (16) Earned Value Management Systems (see 11-202.8 and 11-203.5).
- (17) Performance Based Payments (see 14-910).
- (18) Quarterly Limitation of Payments (QLOP) (see 11-105).

b. A requestor may ask DCAA to evaluate limited portions of the above subject matter by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the subject matter of the report. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an "examination" or a "review";
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-1203 Report Format and Contents (Other Reports)

Prepare reports following the standard aspects of report preparation in 10-200 and the professional standards for audit reporting in Chapter 2. The auditor will also be guided by the reporting concepts contained in Sections 2 through 11 of this chapter and the comments that follow. The report should contain all necessary and pertinent information to be fully responsive to the needs of the recipient. Reports should be prepared using the following format:

Cover Sheet (10-205)

Report Narrative (10-210)

Subject of Audit (10-1204.1)

Executive Summary (10-1204.2)

Scope of Audit (10-210.3)

Qualifications (10-210.4)

Results of Audit (10-1204.5)

Opinion

Exhibits and Schedules

Additional Remarks

(10-210.5e)

Contractor Organization and Systems (10-210.7)

DCAA Personnel and Report Authorization (10-211)

Report Distribution and Restrictions (10-212)

Appendixes, if needed.

10-1204 Report Narrative (Other Reports)

Since this section applies to a variety of audit areas, it is imperative that the "Subject of Audit," "Scope of Audit," and the "Results of Audit" paragraphs be tailored to meet the specific requirements of the audit. Be sure the report does not imply acceptance for purposes other than those intended. For example, a progress payment audit report should not be misconstrued as determining the acceptability or allowability of costs claimed on the contractor's progress payment request.

10-1204.1 Subject of Audit

This paragraph should define why the evaluation was performed. Most of the audits covered in this section are evaluations of a specific contractor submission performed in response to requests. In such cases, the request should be referenced in this paragraph. General guidance is provided in 10-210.1. When the evaluation covers the contractor's compliance with one or more specific laws, regulations, or related requirements, the report format should identify the contractor's implicit assertion that it has complied with the requirements. For example, a report on an examination of compliance with EVMS requirements may read:

"As requested by [requesting office] in [memorandum/letter] [reference] dated __, we examined [contractor name or short name]'s integrated management system to assure that the system complies with the financial and accounting data requirements related to the Earned Value Management System (EVMS) guidelines established in DoDI 5000.2 and incorporated in DFARS 252.242-7002. By submitting invoices under contracts subject to EVMS criteria, the contractor asserts that it has complied with these requirements. The purpose of the examination was to test whether the relevant contractor's systems meet the standards established in DoDI 5000.2 during the period (identify the period covered by the evaluation)."

"Compliance with DFARS 252.242-7002 is the responsibility of the contractor. Our responsibility is to express an opinion on the contractor's compliance with the requirements of DFARS 252.242-7002 based on our examination."

10-1204.2 Executive Summary

Develop an appropriate Executive Summary paragraph using the guidelines provided in 10-210.2 and 10-304.2.

10-1204.3 Scope of Audit

Develop an appropriate scope paragraph using the guidelines provided in 10-210.3. The scope paragraph should describe the criteria used to evaluate the contractor's submission and any scope qualifications. Also describe the impact of the assessment of control risk on the audit scope (see 10-210.3f). If the report covers an evaluation of a contractor's compliance with a specific law or regulation, end this paragraph with the following statement:

"Our examination does not provide a legal determination on [*short name's*] compliance with [*identify law or regulation*] requirements."

10-1204.4 Qualifications

This section sets forth any factors which have a significant adverse impact on the scope of audit and usually result in a qualified report. These circumstances include denial of access to records, nonreceipt of a technical evaluation report, insufficient time to perform the evaluation, etc. The section of the report which contains the detailed discussion of the item involved should be referenced (page number, exhibit, or schedule).

10-1204.5 Results of Audit

a. This section of the narrative tells the report recipient the auditor's opinion and what the audit findings are. If the evaluation was an examination, begin the Results paragraph with the phrase, "In our opinion, [*except for the (describe the qualification and the potential impact on the results)*], . . ." Do not use the term "opinion" to describe the results of a review. If required, this paragraph should be supported by exhibits and schedules.

b. Many major Government contracts contain clauses requiring an approved Earned Value Management System (EVMS) meeting guidelines set forth in DoDI 5000.2 for performance measurement on selected acquisitions (11-200). If the contractor has contracts requiring an approved EVMS, provide an assessment of whether the deficiencies disclosed in the report are likely to materially affect the reliability of the contractor's EVMS. Discuss findings and recommendations relating to the EVMS with the Contract Administration Office EVMS monitor and the audit supervisor prior to issuance of the report. Immediately after issuing the report, the auditor should evaluate the impact of these deficiencies on specific contracts requiring an approved EVMS and where significant provide the details in EVMS surveillance reports (11-203.5.). For example, the systems report might say:

"We believe the deficiencies noted in this report will have a material impact on the reliability of the contractor's Earned Value Management System (EVMS) and on the accuracy of the system's data. Immediately after issuing this report, we will evaluate these deficiencies to determine the impact on specific contracts requiring an approved EVMS and will provide the details in EVMS surveillance reports."

c. Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate:

(1) Exit Conference

(a) In all evaluations, state the date held and the name and title of the contractor's designated representative with whom the exit conference was held (see 4-304). The summary might read as follows:

"We discussed the results of [audit, review, procedures, etc.] with [Name and Title of contractor representative] in an exit conference held on [Date]."

(b) Summarize the contractor's reaction to any factual differences. Include the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(c) If the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Include the following statement:

"The complete text of the contractor's response appears as Appendix [x]."

(2) Other Additional Remarks

Use the guidelines provided in 10-210.5e.(2) to prepare other additional remarks.

10-1204.6 Contractor Organization and Systems (Other Reports)

Follow the guidelines provided in 10-210.7 to prepare comments regarding the contractor organization and systems section of the report.

CHAPTER 11

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CHAPTER 11**11-000 Audit Of Contractor Compliance With Contract Financial Management Requirements****11-001 Scope of Chapter**

This chapter provides guidance that is peculiar or special to the accomplishment of the audit of contractor compliance with contract financial management requirements. To the extent appropriate under the circumstances, Chapters 3, 4, 5, and 6 of this manual are equally applicable to the audit assignments discussed in this chapter.

11-100 Section 1 --- Audit of Contractor Compliance with "Limitation of Cost," "Limitation of Funds," and "Limitation on Payments" Clauses**11-101 Introduction**

This section provides guidance for auditing contractual limitations on costs, funds, and payments.

11-102 General

Contract limitation of cost clauses (FAR 52.232-20 and 21) and limitation of funds clause (FAR 52.232-22) contain financial reporting requirements for cost-type contracts. The contract limitation on payments clauses (FAR 52.216-5, 6, 16, and 17) contain financial reporting requirements for contracts with price redetermination provisions and fixed-price incentive contracts. The limitation of cost and funds clauses in cost-type contracts require the contractor to advise the contracting officer in writing whenever the contractor has reason to believe that costs expected to be incurred under the contract in the next 60 days (may vary between 30 and 90 days) when added to all costs previously incurred, will exceed 75 percent (may vary between 75 and 85 percent) of the estimated total contract costs or funds allotted to the contract, respectively. The limitation of cost clause also requires the contractor to notify the contracting officer when there are indications that the total cost for the performance of a contract will be substantially greater or less than the estimated total contract cost. Under FAR 52.232-20, 52.232-21, and 52.232-22, the Government is not obligated to reimburse the contractor for costs incurred in excess of cost or funding limitations. Similarly, the contractor is not obligated to continue performance under the contract or otherwise incur costs in excess of the limitation or, if the contract is cost sharing, the amount then allotted by the Government to the contract plus the contractor's corresponding share. However, if the Government notifies the contractor in writing that the amount allotted to the contract has been increased and specifies the amount, the Government is then obligated to the total revised amount allotted to the contract. The limitation on payments clause in contracts with price redetermination provisions and fixed-price incentive contracts requires the contractor to report to the contracting officer the costs in relation to billing prices on items for which final prices have not been established. The objective of Limitation on Payments Statement quarterly submissions is to keep billing rates during contract performance in line with expected final prices; indicated overpayments can be recouped and excessive billing rates adjusted on a timely basis. This is a minimum requirement. The contract or the procuring agency may require additional reporting, or the contractor may prepare other internal reports in addition to those required by the Government.

11-103 Scope of Audit

Knowing the management tools available to a contractor in controlling, projecting and monitoring contract costs is of utmost importance. Obtaining this knowledge is an integral part of system audits aimed at determining the adequacy of contractor financial management systems. It is important for the auditor to ascertain that the contractor has the financial management tools necessary to adequately identify potential contract overruns or underruns. The auditor should promptly notify the contractor and the ACO of any deficiencies. In evaluating the contractor's financial management policies and procedures, the auditor should ascertain:

- a. The nature and adequacy of controls which govern the establishment of budgets; the procedures for accumulating incurred costs by budget element; the actual cost compared to budgeted costs; the means provided for comparing incurred costs to the percentage of contract completion; and development of estimates to complete (ETC).
- b. Whether the contractor's organization effectively utilizes its financial management tools to promptly report potential cost overruns and underruns to contractor management and subsequently to the Government.
- c. The methods by which the overall contract financial controls relate to the day-to-day supervisory controls maintained at the operational level.

11-104 Audit Procedures

The audit procedures suggested in this section are not intended to be all-inclusive; the auditor, after considering these guidelines, must develop an audit program based on individual circumstances. At the beginning of the audit the auditor should coordinate with the cognizant contracting officer as discussed in 4-103.

11-104.1 Determination of Reporting Requirements

When appropriate, the auditor should:

- a. Determine, from contract briefing files or other available sources, those contracts which require limitation of cost reports, limitation of funds reports, or limitation on payments statements.
- b. Ascertain whether the contractor is required to meet additional reporting requirements not specifically required by the contract.
- c. Ascertain whether internal reports, in addition to those required by the contract, are prepared to increase internal financial management controls. If so, they should be compared with the reports submitted under the contract to determine whether significant differences exist.
- d. Compare the reporting requirements among various contracts and determine whether there is duplication in the reports required and in the information assembled. The auditor should consider the possibility of the contractor using reports required by one military department, command, or Service to satisfy the needs of all contracting officers.

11-104.2 Evaluation of Reporting Controls

When appropriate, the auditor should:

- a. Evaluate the contractor's procedures applicable to the budgetary controls of individual contracts and compare the estimated cost of individual tasks and departments in the cost estimate with the budgeted funds.
- b. Ascertain and evaluate for each division (or plant) the internal procedures for controlling the financial status of Government contracts and determine the source of the reported incurred costs and the basis for ETC. The auditor also should determine the extent and frequency of supervisory reviews of the status reports and whether explanations are required when there are significant deviations from the budget.

c. Ascertain and evaluate the manner in which revised ETC, in terms of engineering and production manhours, relate to the production control schedules and engineering manpower schedules at specific work centers.

d. Evaluate the documentation flow of the financial status reports from the various sources to the finance manager responsible for preparing the overall financial report for the assigned project.

e. Evaluate the controls exercised by the finance manager, including:

- (1) the manner in which the source data are reviewed for reliability,
- (2) the basis for changes to the source data, and
- (3) a determination of the extent to which requests for explanations from operations responsible for the source data are made relative to causes of potential cost overruns or underruns.

11-104.3 Audit Objectives

The audit objectives are:

- (1) to determine whether the contractor has complied with the reporting requirements contained in the contract clause and
- (2) whether the financial data contained in the contractor's reports and statements are reasonable and consistent with the data presented in other required Government reports and/or claims.

11-104.4 Audit Guidelines

The audit guidelines which are applicable to the minimum reporting requirements in 11-102 are as follows:

a. Ascertain whether the contractor is submitting reports required by its contracts. Compare these reports with the contractor's internal financial reports for consistency.

b. Evaluate limitation of cost reports. The limitation of cost clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of, or will be greater or substantially less than, the estimated cost specified in the contract. The contractor must submit a revised estimate of the total cost of performing the contract as part of the notification. Limitation of cost reports should be evaluated using the following guidance:

- (1) Evaluate the contractor's revised EAC using the guidance in 14-205f.
- (2) Ascertain whether the limitation of cost reports in successive periods reflect significant cost underruns or overruns.
- (3) Ascertain whether the contracting officer has obtained contractor explanations for overruns when continuous overruns have occurred over an extended period.
- (4) When continuous underruns are projected over an extended period, and when the overall estimated contract price has not been reduced, the auditor should ask the contracting officer why.
- (5) When individual contracts indicate continuous significant cost overruns or underruns, the auditor should evaluate this condition in relation to the price established at the time of award. If it is determined that consistent overruns or underruns resulted from defective initial pricing, the contracting officer should be so advised.

c. Evaluate limitation of funds reports. The limitation of funds clause requires the contractor to provide the contracting officer advance notice whenever the total cost incurred on the contract will exceed a specified percentage of the funds currently allotted or, for cost sharing contracts, this amount plus the contractor's corresponding share. This notice must include an estimate of the amount of additional funds required to continue performance for the period specified in the contract. Limitation of funds reports should be evaluated using the guidance in 11-104.4b above.

d. Evaluate limitation on payments statements. Limitation on payments (LOP) statements must be submitted quarterly, in accordance with the provisions of FAR

52.216-5, 6, 16, or 17. The primary objectives of LOP statements are to provide for recoupment of overpayments and to indicate a need for a reduction in billing prices. These conditions become apparent when the contractor is underrunning targets used to establish billing prices. Overruns are indicated when estimated final prices exceed invoice amounts. This indicates possible need for increased billing prices and/or revision of liquidation rates. The general objective is to keep billing prices in line with expected final prices during contract performance. Progress payments and LOP statements should be evaluated at the same time. Even though a request for audit may specify a particular document, auditors should try to identify both submissions with comparable cutoff dates for direct comparison and reconciliation. Evaluate LOP statements and reconcile them to progress payment requests using the following guidance:

(1) The auditor should determine that costs related to delivered items are the same as the amounts excluded from costs shown as a basis for unliquidated progress payments (Item 20a of the progress payment request).

(2) The price of items invoiced should be the same as Item 21a on the progress payment request when both submissions have the same cutoff date.

(3) The EACs used to prepare LOP statements and progress payment requests should be the same. The most current estimates should always be used. EACs should be evaluated using the guidance in CAM 14-205f.

(4) The auditor should assure the comparability of contract items used in computations required by the various subsections of the Limitation of Payments Statement. In all instances, cost data should relate to supplies and services delivered and accepted.

(5) The auditor should determine the methods used by the contractor to identify actual costs of delivered and invoiced items. Understatement of this amount usually results in an overpayment of progress payments by overstating the costs eligible for progress payments applicable to undelivered and uninvoiced items.

(6) The auditor should ascertain whether the contractor makes prompt refunds or adjustments when cost underruns are indicated in the performance of fixed-price redeterminable contracts.

11-104.5 CAS Compliance

The auditor should determine if reporting practices comply with CAS 401, "Consistency in Estimating, Accumulating, and Reporting" (See Chapter 8).

11-105 Reports

Reports will be furnished in response to specific requests for evaluations in this area. Audit reports will be prepared in accordance with 10-1200. When there is reason to recommend correction of a substantial deficiency, a special report will promptly be initiated by the auditor even if there is no request from a contracting officer. Other deficiencies may be included in periodic reports on the overall system of accounting and internal control.

11-200 Section 2 --- Audit of Contractor Compliance with Earned Value Management System (EVMS) Guidelines**11-201 Introduction**

a. This section provides guidance for auditing contractor management systems on selected contracts. The mandatory guidelines that must be met by the contractor are prescribed in DoDI 5000.2.

b. In December 1996, the Under Secretary of Defense (Acquisition, Technology and Logistics) accepted Industry Guidelines for Earned Value Management (EVM) replacing the DoD Cost/Schedule Control System Criteria (C/SCSC). The industry guidelines adopted by DoD are the American National Standards Institute (ANSI)/Electronic Industries Alliance (EIA) EVMS standard (ANSI/EIA-748-1998). The implementation of EVMS guidelines for DoD contracts is contained at DFARS 234.005-70, 252.234-7000 and 252.234-7001. The guidelines represent the framework for an integrated management system that provides for:

- (1) planning the timely performance of work,
- (2) budgeting resources,
- (3) accounting for costs and measuring actual performance against plans, and
- (4) replanning resources needed to complete the contract when significant deviations from plans are identified.

A contractor's management system must meet 32 guidelines organized into the following five major categories: Organization; Planning, Scheduling and Budgeting; Accounting Considerations; Analysis and Management Reports; and Revisions and Data Maintenance. Detailed uniform guidance for implementing the guidelines and conducting systems audits is provided in the Earned Value Management Implementation Guide (EVMIG) (reference DCAA Pamphlet (DCAAP) 7641.47). The EVMIG may be accessed through the DCAA Intranet under DCAA Audit and Administrative Guidance.

c. DoDI 5000.2 requires the implementation of EVM guidelines on contracts or agreements for research, development, test and evaluation (RDT&E) with a value of \$73 million or more; and procurement or operations and maintenance (O&M) contracts or agreements with a value of \$315 million or more (in fiscal year 2000 constant dollars). Exceptions may be made for individual contracts. In any event, the auditor must refer to the specific terms of the contract to determine whether the contract contains reporting requirements for EVMS guidelines. General responsibilities of the auditor during EVMS implementation and surveillance are delineated in the Earned Value Management Implementation Guide (EVMIG), which supplements and elaborates on the provisions of DoDI 5000.2.

d. The Defense Contract Management Agency (DCMA) is the DoD Executive Agent responsible for the implementation of EVMS on DoD contracts. DoD components are required to implement earned value effectively and notify DCMA of their EVMS focal point.

e. Since DoD's C/SCSC are considered to be equivalent to EVMS guidelines, contractors' previously approved cost/schedule control systems are considered to be acceptable under the EVMS guidelines. Accordingly, contractors with acceptable cost/schedule control systems under C/SCSC are not required to demonstrate that their management systems meet the EVMS guidelines, and are not subject to the initial compliance audit procedures outlined in 11-202.2.

11-202 EVM Integrated Baseline Reviews, Initial Compliance Audits, and Post Acceptance Audits for Cause

11-202.1 Integrated Baseline Reviews

The Integrated Baseline Review (IBR) is a joint assessment conducted by the Government and the contractor following contract award to verify the technical content of the Performance Measurement Baseline (PMB) and the accuracy of the related resources (budgets) and schedules. The IBR will be conducted within six months of contract award. An IBR will also be conducted when work on a production option of a development contract begins or, at the discretion of the program manager, when a major modification to an existing contract significantly changes the existing PMB. The IBR is a streamlined approach to assessing the PMB on new contracts. The IBR is conducted under the assumption that the contractor is using an accepted EVMS internally for program management, and that there is a thorough and effective Government surveillance program ongoing at the contractor's facility. Therefore, this audit is not as comprehensive as the initial compliance and post-acceptance audits of contractors' EVMSs. Accordingly, audit assistance will not usually be requested. However, when any part of the system is not clearly understood, the assistance of the auditor may be desired. If the assistance of the auditor is needed, the program manager will notify the cognizant auditor as soon as possible. The auditor will be responsive to the program manager for evaluation of those accounting and/or financial aspects of the contractor's system.

11-202.2 Initial Compliance Audits

a. DFARS 252.242-7002, Earned Value Management System, requires the contractor to be prepared to demonstrate that its management system complies with the EVMS guidelines as required by DoDI 5000.2. Contractors whose EVMS was accepted for application to another contract of the same type (e.g., development or production) at the same facility will not be required to undergo an initial compliance audit. The initial compliance audit is conducted by a DoD team whose leader is appointed by DCMA. The team includes a DCAA auditor. Team members should be advised in advance of the estimated audit start date and furnished information about the contractor's EVMS.

b. The team will make a Progress Assistance Visit (PAV) to the contractor's facility, normally within 30 days after contract award, to conduct an initial audit of the EVMS description. The contractor will usually make presentations on the EVMS's design and operation and explain applicable reports. The team will examine selected documents and procedures proposed by the contractor, and a schedule will be developed for future visits to conduct the IBR and the initial compliance audit. Areas of noncompliance and potential problems will be identified. Recommendations for systems improvements should be forwarded to the team leader for evaluation and discussion with the contractor. The contractor will be given an opportunity to correct noted deficiencies.

c. The EVMS initial audit should begin as soon as practicable following completion of the PAV and implementation of the EVMS. The contractor will demonstrate to the team how the EVMS is structured and used in actual operation. The contractor shall provide the team with a written description of the EVMS. The review team will examine contractor records and information to ascertain compliance with the EVMS guidelines and document its findings.

d. After the demonstration review, the team will conduct the initial compliance audit using the system characteristics contained in the EVMS Evaluation Guide (Appendix B of the EVMIG). During the initial compliance audit, the contractor will provide an overview briefing to familiarize the team with the proposed EVMS and identify any changes to the EVMS since the most recent PAV. If necessary, the team will evaluate any changes to the PMB since the most recent IBR. The team will evaluate, on a sampling basis, the reporting of cost and schedule performance against the baseline plan to verify the adequacy of con-

tractor controls and accuracy of management reporting information. The team may conduct interviews of selected contractor personnel to verify that the EVMS is fully implemented and being used in the management of the contract. A report will be issued 30 days after completion of the audit and approval of all significant contractor corrective actions, if necessary.

e. A system for controlling development effort is generally different from a system for controlling production work; accordingly, separate initial compliance audits may be required for each, although only one program may be involved. Simultaneous audits of the EVMS used for development and production may be performed. This eliminates the necessity for multiple audits. In addition, the contractor may implement one system for both types (development and production) of contracts. When the contractor implements one system for both types of contracts, the system to gain acceptance must clearly demonstrate that it meets the guidelines applicable to production type contracts in the way work is planned and controlled and the way costs are collected and analyzed. The focus of the compliance audit will be determined by the extent and nature of the production effort in the contract.

f. After the successful completion of an initial compliance audit, an advance agreement between the Government and the contractor is executed, which specifies that the contractor will maintain and use the accepted EVMS as an integral management process on the current, as well as future, contracts. The agreement should be incorporated into each contract requiring the application of the EVMS guidelines. The agreement is signed by the ACO and a contractor representative at the commensurate level, e.g., the division manager may sign the agreement when the EVMS is used throughout the corporation's division. In addition, a Memorandum of Agreement (MOA) may be executed between the Program Management Office (PMO) and the Contract Management Office (CMO). The MOA identifies key Government EVMS individuals and establishes the working relationships between the PMO and CMO. Auditors normally should not be requested to sign advance agreements or MOAs. The auditing standard of independence precludes DCAA from entering into most agreements. Auditors may communicate in writing by a memorandum to the CMO the auditor's expected role in the EVMS surveillance process. If the CMO insists on the FAO entering into an advance agreement or MOA, the FAO should send the proposed agreement or MOA and background material through the regional office to Headquarters, ATTN: P, for coordination before executing the agreement or MOA.

11-202.3 Post Acceptance Audits for Cause

After the initial acceptance of a contractor's EVMS, no further audits for system acceptance will be conducted unless there is a specific need determined by the Government. A post acceptance audit may occur when conditions warrant, e.g., solving a major system application problem identified by the program manager or a surveillance monitor. The scope and conduct of the audit will focus on the system processes affected by the problem. The audit will be scheduled based on written Government notification to the contractor. The review team director will be selected by the CMO EVMS monitor and the review team will be composed of the appropriate EVMS Government surveillance personnel needed to address the identified problem. The review is similar to an initial compliance audit, and the EVMS Evaluation Guide should be used when compliance with specific guidelines is required. The review director will issue a report within 30 days after completion and approval of all significant contractor corrective actions.

11-202.4 Auditor Participation in Integrated Baseline Reviews, Initial Compliance Audits, and Post Acceptance Audits for Cause

Upon receipt of a specific request, the FAO will assign an auditor to be a member of the IBR, initial compliance audit, or post acceptance audit for cause team. Auditors assigned to these teams should be familiar with the EVMIG and have some training in

EVMS guidelines. Prior to the audit, auditors should become thoroughly familiar with the contractor's EVMS by reviewing the contractor's system description and analyzing cost management reports for the contract under audit, if applicable.

11-202.5 Audit Objectives

The auditor's primary objective is to audit the accounting system and related financial areas to determine whether the management control system complies with the EVMS guidelines on areas assigned and is being implemented on the contract under audit. The auditor is responsible for advising the team chief, on the areas audited, of the conclusions and will be responsible to the team chief for the timely completion of the effort specifically assigned. As members of an EVMS guidelines review team, auditors may be involved in cost account/functional manager interviews, questionnaire completion, discrepancy report preparation, documentation audits, and audit report preparation. Auditors should perform as much preliminary work as possible in advance of the team visit in order to provide conclusions on any EVMS deficiencies to the team chief by the end of the EVMS guidelines audit.

11-202.6 Scope of Audit

a. The DCAA team member is responsible for the preparation and execution of a detailed audit program for all areas assigned by the team chief. Technical direction will be provided by an audit supervisor. Auditors should also assess whether deficiencies disclosed in reports on MMAS, labor, other accounting systems, forward pricing rates, budgets, and billing systems are likely to affect the contractor's EVMS. If the contractor has other contracts requiring an approved EVMS, the auditor should also determine if deficiencies being reported in EVMS surveillance reports (11-203) have an impact on the contract under audit.

b. The auditor is responsible for advising the team chief, on the areas audited, whether the management system meets the requirements of the EVMS guidelines. Unresolved disagreements between the auditor and review team chief should be referred to the regional office and, when necessary, to DCAA Headquarters, ATTN: P.

c. If the auditor becomes aware of significant accounting or financial aspects of the contractor's EVMS that have been omitted from the IBR, initial compliance audit, or post acceptance audit for cause, thereby resulting in an inadequate review of the system, the circumstances should be immediately brought to the attention of the team chief and documented in the DCAA files. Comments on these matters should also be included in the audit report together with statements regarding their expected impact on the system and related reporting of contract performance.

d. An EVMS is intended for contractor use in managing contracts and for Government use in monitoring contract performance. Application of the provisions of DoDI 5000.2 should not result in the development or use of two systems, one for the contractor's internal use and the second merely to satisfy the intent of the guidelines. Evidence of intended or actual parallel operation should be fully evaluated and the results discussed with other members of the EVMS guidelines review team. A determination that only one system will be used is necessary prior to acceptance of the proposed EVMS.

e. Unrestricted access to all data affecting contract costs, both direct and indirect, including budgets and operating forecasts, is necessary to properly audit an EVMS. If the contractor refuses access to required data, the auditor will advise the team chief and the CMO EVMS monitor and enlist their aid in obtaining the information. If the contractor continues to deny access, the auditor will recommend, in writing, that the system not be accepted. In the event that access to required data is made available during the audit, but the auditor has been formally advised by an authorized representative of the contractor that the data will be withheld during the surveillance process, a comment to that effect will be

included in the audit report, together with a statement that lack of access to data may result in qualification of system surveillance audit reports.

f. In addition to serving as EVMS guidelines review team members, auditors are responsible for monitoring contractor corrective action in assigned areas. If the contractor fails to take effective corrective action or fails to make acceptable progress in resolving deficiencies, contractual remedies should be recommended (e.g., withhold progress payments, disallow costs).

g. In those cases when management control acceptance is delayed for an extended period of time after contract award because the system has not been fully accepted or has been found to be unacceptable, DCAA surveillance activities should concentrate on verification of reported data and consistency between cost and schedule information and information from other contractor systems.

11-202.7 Audit Procedures

a. Select those tests and other auditing procedures that are necessary to adequately complete the work assigned. These procedures will include tests to verify that the management control system meets the guidelines for the areas assigned. Make maximum use of prior audits and knowledge accumulated by prior audit staff so as to avoid duplication of effort. However, auditors should conduct sufficient tests of the assigned guidelines during each EVMS guidelines review to confirm that the management control system has in fact been implemented on the contract being audited.

b. In evaluating whether a contractor's management control system complies with the guidelines, the auditor should conduct audit procedures similar to those performed during surveillance of the EVMS guidelines (11-203.3). Guidelines which DCAA is commonly asked to evaluate include: Organization Guideline 4; Planning, Scheduling and Budgeting Guidelines 8, 9, and 13; all of the Accounting Considerations Guidelines; Analysis and Management Reports Guidelines 22, 24 and 27; and Revisions and Data Maintenance Guideline 30. See Part I, Section 3 of the EVMIG for a narrative description of each EVMS guideline. The team members should use the EVMS Evaluation Guide, Appendix A of the EVMIG (DCAAP 7641.47), as necessary in the examination of contractor management control systems to ensure compliance with the guidelines. The EVMS Evaluation Guide includes a restatement of guidelines, followed by the related system characteristics expected to be part of an acceptable EVMS. Auditors will need to perform specific audit steps to verify that the expected system characteristics are present in the contractor's EVMS.

c. The auditor's supervisor will provide technical direction to assure the proficiency of the work performed. All work will be reviewed by the supervisor prior to forwarding reports or conclusions to the team chief.

11-202.8 Reporting Results of Audit

a. When the audit work related to an IBR, initial compliance audit, or a post acceptance audit for cause is finished, the auditor will discuss the findings and recommendations with the audit supervisor and furnish them to the team chief in such form and detail as required for the EVMS guidelines review team report, using the general guidelines provided in 10-1200. Any findings and recommendations will be provided to the team chief prior to completion of the in-plant effort of the EVMS guidelines review team to enable the team chief to conduct the exit conference with the contractor. The FAO will retain the detailed working papers covering DCAA's part of the audit. Working papers supporting the auditor's conclusions regarding compliance or noncompliance with specific guidelines will be documented in all instances and will include a record of the conclusions which have been furnished to the team chief. Reported deficiencies should be identified to specific guidelines or the contractor's system description whenever possible. The auditor's report will be formally issued as soon as possible after the EVMS guidelines review team exit conference.

ence with the contractor. The team chief will also be provided with any summary schedules and/or copies of working papers required for consolidation of statistical data or as additional supporting documentation for the EVMS guidelines audit file.

b. Provide Headquarters, ATTN: P, with a copy of each report which meets any of the following criteria:

- (1) Recommends the disapproval of a previously accepted EVMS.
- (2) Discloses significant discrepancies in a contractor's EVMS.
- (3) Discloses significant restrictions on the audit caused by a denial of access to records.

11-203 EVM Surveillance Audits

a. Immediately following demonstration and acceptance of the contractor's management control system, surveillance by DCAA and the Contract Management Office (CMO) is performed to ensure that the contractor's system continues to comply with the EVMS guidelines and produces valid and timely data. Surveillance is also performed to ensure that any proposed or actual changes to the EVMS comply with the guidelines and are reflected in the contractor's system description. Surveillance includes verifying, tracing, and evaluating the information contained in the reports submitted to DoD procuring components. In the event deficiencies are disclosed, or if there is an indication of an adverse effect on contract performance because of such deficiencies, discuss the deficiencies with the contractor and notify the CMO EVMS monitor.

b. Basic auditor responsibilities during surveillance audits are summarized in Part II, Section 3-2a(3) of the EVMIG; more specific audit guidance is provided in the following paragraphs. The auditor's surveillance responsibilities, as identified in the EVMIG, include:

- (1) reviewing the contractor's accounting system policies and procedures for compliance with EVMS guidelines and contract provisions (system surveillance) and
- (2) performing periodic reviews of selective financial data contained in various reports submitted by the contractor to determine whether they accurately reflect the contractor's books and records (report surveillance).

c. A written description of the acceptable EVMS should be furnished to the auditor by the CMO EVMS monitor. The EVMS description should be included in the permanent files and used for planning the surveillance audit program.

d. To ensure adequate evaluation of the system and related output, and to preclude any duplication of effort, the FAO's programmed surveillance audits should be coordinated with the CMO EVMS monitor. This coordination should include a discussion of those aspects of the system scheduled for audit, as contained in the FAO's annual plan. The program monitor should also be advised of other evaluations scheduled that may relate directly or indirectly to the EVMS. Formal agreement for surveillance activity should not be undertaken since the degree of surveillance required may vary considerably between contracts and from one period of contract performance to another.

e. As a minimum, the procedures contained herein will be considered in developing an audit plan for an EVM surveillance audit. The audit should include the procedures necessary to address any additional areas requested by the ACO or CMO EVMS monitor.

f. It is the prime contractor's responsibility to accept and maintain surveillance of subcontractor EVMSs. However, there are unique situations when a subcontractor EVMS will be accepted and/or surveillance will be performed by a DoD component rather than a prime contractor. This may occur when:

- (1) the subcontractor, for competitive reasons, refuses access to records to a prime contractor;
- (2) the subcontractor is performing multiple contracts containing EVMS reporting requirements under more than one prime contractor; or
- (3) the subcontractor may be functioning as a prime contractor on an accepted EVMS.

g. In the instances described in f. above, the cognizant auditor at the subcontractor location will perform the necessary system surveillance by following the procedures described herein. When the prime contractor has retained surveillance responsibility, the audit plan at the prime contractor location should include the following steps:

(1) The prime contractor's program for surveillance of the subcontractor's EVM system should be evaluated to determine depth, scope, and overall adequacy.

(2) The results of the prime contractor's surveillance efforts, including follow up, should be evaluated to ensure that deficiencies are subsequently corrected.

(3) The results of the prime contractor's evaluation of subcontractor-reported data, including action taken by the prime on significant variances reported by the subcontractor, should be evaluated. The auditor should verify that estimates to complete the subcontract are revised to reflect the impact of significant variances.

(4) The timeliness of subcontract reporting and subsequent incorporation of related data in the prime contractor's monthly report should be evaluated.

(5) The auditor should report the need for necessary assist audits on areas not adequately evaluated by the prime contractor and on deficiencies disclosed by the prime contractor's surveillance activities that have gone uncorrected over an extended period of time. In this connection, auditors at subcontractor locations should advise auditors at prime contractor locations of any deficiencies noted during the system audit that may have an impact on the continued acceptability and validity of the subcontractor's system and related output. Routing of requests for assist audits and submission of audit reports will be accomplished through ACO channels.

11-203.1 Audit Objectives

a. System Surveillance. The objectives of the system surveillance portion of the audit are to ensure that the contractor's management control system continues to:

- (1) provide valid and timely management information;
- (2) comply with the DoD EVMS guidelines;
- (3) provide timely indications of actual or potential problems; and
- (4) provide baseline integrity.

b. Report Surveillance.

(1) The objectives of the report surveillance portion of the audit are to ensure that the contractor's required external cost management reports (CPR, C/SSR and CFSR) contain:

(a) information that is derived from the same data base as that used by contractor management;

(b) explicit and comprehensive variance analysis, including proposed corrective action in regard to cost, schedule, technical, and other problem areas; and

(c) information that depicts actual conditions.

(2) The cost management reports typically generated by a contractor's EVMS include:

(a) Cost Performance Report (CPR)

The objective of the CPR (DD Form 2734) is to provide data to Government system managers that may be used by them to:

- (i) evaluate contract performance,
- (ii) identify actual and potential problem areas having significant cost impact, and
- (iii) respond to requests for program status information on major weapon/support system acquisitions.

To permit this type of management control, the CPR requires, among other things,

- information on cost and schedule performance by work breakdown structure and functional cost categories,
- actual manpower utilization versus the budgeted plan, and
- narrative comments explaining major cost and schedule variances, as well as an identification of significant problems and action contemplated for their resolution.

The CPR is submitted monthly unless otherwise provided for in the contract.

(b) Cost/Schedule Status Report (C/SSR)

The objective of the C/SSR (DD Form 2735) is to provide summarized cost and schedule performance status information on contracts over 12 months in duration when application of the Cost Performance Report (CPR) is not appropriate. The C/SSR requires:

- (i) information on cost schedule performance by work breakdown structure and
 - (ii) narrative comments explaining major cost and schedule variances, as well as identification of significant problems and action contemplated for their resolution.
- The C/SSR is submitted in accordance with the terms specified in the contract, but is not required more frequently than monthly.

(c) Contract Funds Status Report (CFSR)

The objective of the CFSR (DD Form 1586) is to provide information about contract funding requirements for specifically designated programs to assist the system manager in:

- (i) updating and forecasting contract fund requirements,
- (ii) planning and decision making on changes in the fund requirements,
- (iii) developing fund requirements and budget estimates in support of approved programs, and
- (iv) determining funds in excess of contract needs and available for deobligation.

The CFSR is normally prepared quarterly and submitted within 25 calendar days after the cut-off date or the number of days specified in the contract. Under unusual circumstances monthly reporting may be required.

11-203.2 Scope of Audit - General

a. EVM surveillance audits should be performed at least once a year, but should be performed as frequently as necessary to ensure continued reliance on the system and related output. Based on a risk assessment, the scope of the surveillance audit may:

- (1) include system and report surveillance or
- (2) be limited to report surveillance.

b. An initial determination of the overall scope of the surveillance audit (i.e., system and report surveillance or report surveillance only) will be made based on a risk assessment performed as part of the annual program planning process. Report surveillance will be performed on at least an annual basis. The need for system surveillance will be based on the following criteria:

(1) A detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines should be performed every two to four years.

(2) If a detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines has been performed within the last two to four years, a limited system evaluation should be planned to cover the portions of the system affected by the following specific risk factors, to the extent that they exist:

- (a) changes in the system since the last detailed evaluation was performed,
- (b) related internal control deficiencies, and
- (c) any specific ACO concerns.

(3) If a detailed evaluation of the EVM system's continuing adequacy and compliance with EVMS guidelines has been performed within the last two to four years, and none of the risk factors identified above exist, no system surveillance is required for the current FY. Only report surveillance would be required.

11-203.3 Scope of Audit - System Surveillance

a. System surveillance may consist of either a detailed evaluation, encompassing all of the EVM guidelines assigned to DCAA, or may be limited to the guidelines related to the specific risk factor identified.

b. In evaluating the compliance with the EVM guidelines, the auditor should consider the system characteristics related to the guidelines, as contained in the EVMS Evaluation Guide.

c. The auditor should consider the testing performed in related internal control audits (e.g., planning and budgeting, MMAS) when determining the testing required in the system surveillance audit. The testing performed in the related internal control audits should be used, to the extent possible, in determining the contractor's continued compliance with the EVM guidelines under review.

d. If the contractor's system has changed since the last surveillance audit, the auditor should evaluate the changed policies and procedures for continued compliance with the EVM guidelines under review.

e. For all system surveillance audits, the auditor should select a sample of contracts to test to ensure the contractor has followed through with the implementation of the guidelines on contracts.

11-203.4 Scope of Audit – Report Surveillance

a. A universe of contracts with cost management reporting requirements (e.g., CPR, C/SSR, or CFSR) should be developed during the annual program planning process. Auditors may develop the universe of contracts based on:

- (1) data obtained from the contractor,
- (2) data obtained from the ACO,
- (3) briefing contract provisions, specifically the Contract Data Requirements List (CDRL), DD Form 1423, or
- (4) a combination of the data sources.

The universe of contracts should include contracts containing EVM requirements (DFARS 252.234-7001) as well as contracts which, while they do not contain the EVM requirement, include requirements for submission of the CPR, C/SSR, or CFSR.

b. The auditor should coordinate with the ACO to identify any sensitive, high risk, or high visibility contracts.

c. The auditor should select a sample of contracts to be tested as part of the annual EVM report surveillance. The sample of contracts should reflect:

(1) high-risk or sensitive contracts, including contracts where problems were identified in prior year testing, plus

(2) a three-year cycling of all other contracts containing reporting requirements, with at least one contract tested per year. The auditor should determine the extent of testing of report data and select the specific reports to be tested under the selected contracts based on the results of the audit risk assessment.

d. The auditor should audit the selected reports using the procedures below.

(1) Evaluation of Cost Management Reports (CPR, C/SSR, CFSR)

The purpose of evaluating the selected cost management reports is to ensure that the reports:

- (a) are mathematically accurate;
- (b) comply with contractual requirements, such as reporting due dates, format; and content; and
- (c) are supported by the contractor's books and records.

The Performance Measurement Baseline is the time-phased budget plan against which contract performance is measured. It is formed by the budgets assigned to scheduled cost accounts and the applicable indirect budgets, which may also be known as the scheduled direct costs and applicable expense rates, and is sufficiently detailed to the work package level to ensure adequate performance measurement. The Budgeted Cost for Work Scheduled (BCWS) is the sum of budgets for all work packages scheduled to be accomplished and is the measurement of work scheduled to be accomplished within a given time period. The Budgeted Cost for Work Performed (BCWP) is the sum of budgets for completed work accomplished. The Actual Cost of Work Performed (ACWP) is the cost incurred and recorded in accomplishing the work performed within a given time period. Each of these terms is precisely defined in Appendix D of the EVMIG (See DCAAP 7641.47). The auditor should consider the following procedures in evaluating the selected reports:

(i) From the lowest levels, work packages, or cost accounts, the auditor should summarize the budgeted and actual costs (accrued expenditures for the CFSR) through the Work Breakdown Structure (WBS) to the contract level and the CPR, C/SSR, or CFSR. This should be done for both the current month and cumulative to date amounts.

(ii) The auditor should verify that the BCWS and the BCWP on the CPR or C/SSR were computed in accordance with the Performance Measurement Baseline for the contract.

(iii) Amounts should be summations from the lowest points of accumulation without intermediate allocations.

(iv) Indirect cost and labor rates applied should be the originally planned rates for work scheduled (BCWS) and work accomplished (BCWP). Also, verify that acceptable rates are used for actual costs (e.g., the rates are calculated and applied in accordance with the contractor's usual/disclosed cost accounting practices).

(v) The auditor should obtain and review the contractor's reconciliation of the selected reports to its job cost ledgers. Selectively trace the reported actual cost data to the contractor's job cost ledgers.

(vi) Deficiencies disclosed or errors noted should be discussed with contractor personnel for subsequent correction. Schedule subsequent surveillance audits to verify that required follow-up actions have been completed.

(2) Reconciliations of Cost Management Reports (CPR, C/SSR, CFSR)

The purpose of reconciling external cost management reports, such as the CPR, C/SSR, and CFSR with each other and with contractor internal reports and other external reports, such as the Contractor Cost Data Report (CCDR), Quarterly Limitation on Payments (QLOP), progress payment requests, and public vouchers, is to ensure that the information being reported is accurate and differences in data from one report or level to another are logical, consistent, and explainable. The contractor should make the necessary reconciliations. The auditor should perform the following validation steps:

(a) The auditor should verify reconciliations between the CPR or C/SSR and the CFSR for contract target, actual cost, and estimated final cost.

(b) When applicable, the auditor should verify reconciliations of internally-reported and CPR or C/SSR-reported data with CCDR-reported data or other external data for actual costs to date and estimated final cost.

(c) In those instances when the reports do not reconcile or the reasons for variances do not appear valid, the auditor should coordinate with the ACO and the CMO EVMS program monitor in recommending necessary changes to ensure that subsequent valid reconciliations can be made.

(3) Evaluation of Estimate at Completion Reported on Cost Management Reports (CPR, C/SSR, and CFSR)

(a) The frequency of evaluations of the latest revised estimates at completion (EAC) for a contract will depend upon the adequacy of the contractor's procedures, including internal audit procedures and the extent of contract changes which may, to some extent, give rise to revisions to the anticipated cost at completion. Because of the importance of estimated costs at completion, to both the contractor and the Government, the auditor should perform a critical evaluation of the contractor's proposed amount. Coordination with technical personnel is necessary to properly evaluate the estimate at completion and preclude duplication of effort.

(b) Contractors sometime report EACs to the Government for billing and EVMS guidelines purposes that are different than those used for financial reporting purposes because of different risk assumptions and profit expectations. This is not a problem if the contractor can reconcile the differences. While it is necessary for auditors to compare EACs used by contractors for financial reporting purposes with those reported to the Government, the provisions of DoDI 5000.2 and the EVMS guidelines do not require a contractor to make such reconciliations, and should not be used to gain access to financial statements. However, auditors should evaluate multiple EACs disclosed during EVMS guidelines audits. The contractor's inability to provide reconciliations may indicate performance to date and

estimates of future conditions are not being accurately reflected in the contractor's EAC process, which could be an EVMS deficiency. Auditors should typically pursue access to EACs used for financial reporting purposes in these instances under billing system/progress payment audits.

(4) Variance Analyses (CPR, C/SSR)

(a) The CPR and C/SSR provide for monthly disclosure of schedule and cost variances and contractor comments on significant problem areas, reasons for variances, their impact on the program, and corrective action taken or to be taken. The purpose of the variance analysis is to assess variances in terms of their contribution to cost growth and schedule slippage. The auditor's responsibilities with respect to evaluating variances are to ensure that timely and responsible actions are taken by the contractor to:

(i) identify their causes and

(ii) minimize the impact of the variances on contract performance.

(b) Since schedule slippage and problems in technical performance contribute to variances, the evaluation of variances and the contractor's proposed actions with respect thereto should be coordinated with the Government program monitor and/or technical personnel. The following steps should be followed in evaluating variances:

(i) On a sampling basis, the auditor should select areas of significant cost variances, including those caused by indirect rate variances, as identified in the CPR or C/SSR, and trace to the required action level. The CPR or C/SSR generally provides for reporting of indirect expenses as a line item. The contractor will analyze significant variances between the planned and actual rates and, when unfavorable variances exist, the contractor should indicate the cause and corrective action to minimize the effect on cost performance. The auditor should be aware of rates used to establish the performance measurement baseline as related to the rates being reported, and also of any anticipated changes expected to occur that affect the value of planned effort, such as volume fluctuation, terminations, and revisions to the rate structure. Surveillance reports should indicate the actions taken by the contractor with respect to unfavorable variances and also data on expected changes that may create significant variances in subsequent periods.

(ii) The auditor should determine if the narrative descriptions of the variances are valid and adequate.

(iii) Causes and proposed remedies of the variances should be discussed with the contractor to determine if proposed actions will be responsive to the nature of the problem.

(iv) The auditor should evaluate estimated cost at contract completion to determine if the impact of any existing variances are reflected in the estimate to complete the contract.

(v) As necessary, the auditor should follow-up to ensure the contractor has effectively implemented its proposed corrective action(s) on the significant variances.

11-203.5 Reporting Results of Audit

a. As discussed in 11-203.2a, the scope of the EVM surveillance audits may include system and report surveillance or be limited to report surveillance.

The surveillance audit report should be prepared in accordance with 10-1200 and provide clear statements of the scope of the audit (i.e., system and report surveillance or report surveillance only) and any deficiencies noted, together with recommendations for their correction. Comments should also be provided regarding the results of discussions with the contractor's representative on deficiencies disclosed. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the CMO EVMS monitor prior to issuance of the report. Systemic EVMS deficiencies should be highlighted in the report. Whenever possible, the auditor should relate any deficiencies to specific EVMS guidelines. The report should be issued in a timely manner to ensure report recommendations may be acted on appropriately. The report should be addressed to the principal cognizant ACO. A copy of the report will be provided directly to the CMO EVMS monitor, the affected program office(s), and the FLA(s) where applicable. A copy

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of each report meeting any of the criteria stated in 11-202.8.b above will also be provided Headquarters, ATTN: P.

b. When applicable, surveillance reports should include a reference to reports issued on the results of system audits (see 10-408.2f) that had an impact on or were affected by the EVMS.

c. Deficiencies being reported in surveillance reports should also be reported in audit reports in an appendix on Other Matters on proposals expected to result in contracts covered by DFARS clause 252.234-7001, Earned Value Management Systems, or DFARS clause 252.242-7005, Cost/Schedule Status Report.

d. When deficiencies are disclosed while performing audits of material management and accounting systems (MMAS), labor, other accounting systems, forward pricing rates, budgets, and billing systems, the auditor will assess whether the deficiencies are likely to have a material effect on the reliability of the contractor's EVMS and provide comments in the related report on the system or forward pricing rates. The auditor should immediately evaluate the impact of these deficiencies on the contractor's EVMS data for specific contracts and, where material, provide the details in a flash EVMS surveillance report (10-1200). When a flash report is issued, periodic EVMS surveillance audits are still required.

e. When an audit of a CFSR submission discloses that a loss is anticipated for a fixed-price contract, the auditor will ascertain whether the contractor is entitled to progress payments. If so, the auditor should make sure that the indicated rate of loss disclosed in the CFSR audit is appropriately applied by the contractor for purposes of computing its progress payment request.

f. Continued availability of information supporting earned values, incurred costs, and estimates to complete is necessary to perform proper surveillance of EVMS. In the event access to required contractor data is withheld or unduly restricted, follow the procedures in 1-500. When denial is continued, each surveillance report should include appropriate modification of the scope and opinion statements, with identification of the data being denied and its relationship to system surveillance requirements. If internal management budgets and forecast data are not made available during the surveillance audit, the auditor should qualify the audit report and recommend that the system validation be withdrawn. When applicable, the CAC should establish uniformity in necessary report qualifications to ensure consistency within corporate structures when more than one corporate segment is subject to EVMS requirements.

11-204 Requested Audits of Individual CPR, C/SSR, and CFSR Reports

Periodically, contracting officers may request audits of individual cost reports submitted by EVM-covered contractors. Auditors should use the procedures set forth in 11-203.4d, modified as appropriate, to evaluate the individual report submissions. Reports on individual CPR, C/SSR, or CFSR submissions should be prepared in accordance with 11-203.5.

11-300 Section 3 --- Audit of Selected Cost Management Reports Submitted by Contractors Without Earned Value Management (EVM) Reporting Requirements

11-301 Introduction

This section provides audit procedures and guidance for auditing contractor management control systems, and the related cost reports (Contract Performance Reports (CPRs), previously Cost Performance Reports), Cost/Schedule Status Reports (C/SSRs), and Contract Fund Status Reports (CFSRs)) at contractors who do not have contracts containing earned value management (EVM) reporting requirements. Audit guidance for contractors with EVM reporting requirements is contained in 11-200.

11-302 Background

a. Over many years, the Office of the Secretary of Defense and the military departments have developed a variety of management systems for use in the acquisition process. These systems provide the Government with the ability to obtain timely and valid cost, funding, schedule, and related management information for use in contract performance analysis and program control. In March 1996, DoD Directive 5000.1, and DoD 5000.2-R, "Mandatory Procedures for Major Defense Acquisition Programs (MDAPs) and Major Automated Information System (MAIS) Acquisition Programs," respectively, were issued replacing all previous DoD acquisition management policies and procedures. DoD contract cost management reporting requirements such as the CPRs, C/SSRs, and CFSRs were contained in DoD 5000.2-R, Subpart 7.15.7, "Contract Management Reports" until October 30, 2002. On October 30, 2002, DoD Directive 5000.1 and DoDI 5000.2 were canceled and replaced with interim guidance. DoD 5000.2-R was converted from regulation to non-mandatory guidance and is now referred to as the Defense Acquisition Guidebook. In May 2003, DoD Directive 5000.1 and DoDI 5000.2 were reissued. Under the reissued DoD Directive 5000.1 and DoDI 5000.2, cost management reporting using the CPR, C/SSR, and CFSR is no longer mandatory, but rather at the discretion of the contracting officials. DCAA audit effort related to the CPR, C/SSR, and CFSR at contractors who do not have contracts containing EVM reporting requirements primarily involves the evaluation of contractor financial records to validate the accuracy and propriety of reported data.

b. The audit of a contract and the briefing of its provisions (see 3-200) will disclose whether the contract incorporates CPR, C/SSR, or CFSR reporting requirements.

(1) Contract Performance Report (CPR) (previously Cost Performance Report). The objective of the CPR (DD Form 2734) is discussed in 11-203.1b(2)(a).

(2) Cost/Schedule Status Report (C/SSR). The objective of the C/SSR (DD Form 2735) is discussed in 11-203.1b(2)(b).

(3) Contract Funds Status Report (CFSR). The objective of the CFSR (DD Form 1586) is discussed in 11-203.1b(2)(c).

11-303 Audit Requirements

a. An annual risk assessment will be performed during the annual program planning process for each contractor without EVM-covered contracts, but with contracts containing CPR, CSSR, and/or CFSR reporting requirements. The risk assessment considers:

- (1) the number of contracts containing CPR, C/SSR, or CFSR reporting requirements,
- (2) sensitive or high risk contracts or conditions identified by the ACO, and
- (3) the expected volume of covered contract reports where an audit will be requested.

The risk assessment is used to determine whether to perform a self-initiated audit of the contractor's policies and procedures for accumulation of data and preparation of CPRs, CSSRs, and/or CFSRs, as well as selectively testing financial data contained in them.

b. Audits of individual CPR, C/SSR, or CFSR reports may be requested by the contracting officer. The contracting officer may also request an audit prior to the award of a

contract under which CPR, C/SSR, or CFSR requirements are contemplated to determine if the contractor's management system and procedures are adequate and reliable for CPR, C/SSR, or CFSR purposes, and will also consider the contractor's procedures for accumulating and reporting actual costs (cumulative expenditures for CFSR) and for estimating contract completion costs.

11-304 Audit Objectives and Procedures

a. Where an audit of the contractor's management system and procedures relative to CPRs, C/SSRs, and CFSRs is required, either based on a specific request from the contracting officer or based on the risk assessment described in 11-303a, evaluate the contractor's policies and procedures for developing and reporting actual and projected costs in the CPRs, C/SSRs, and CFSRs to ensure the system will produce accurate data that complies with contractual reporting requirements.

b. Use the procedures at 11-203.4d to perform audits of individual CPR, C/SSR, or CFSR reports requested by the contracting officer. Also use the procedures at 11-203.4d to selectively test financial data contained in the CPRs, CSSRs, and/or CFSRs submitted by the contractor, based on the risk assessment described in 11-303a.

11-305 Reporting Results of Audit

a. An audit report will be prepared:

(1) on each audit of contractor management system and procedures requested by the contracting officer,

(2) in response to the request of the contracting officer for audits of individual CPRs, C/SSRs, or CFSRs, and

(3) on each self-initiated audit of the contractor's policies and procedures for accumulation of data and preparation of CPRs, C/SSRs, and/or CFSRs.

b. Audit reports will be prepared in accordance with 10-1200 and provide clear statements of the scope of the audit and any deficiencies noted, together with recommendations for their correction. To ensure that all pertinent data have been considered, the audit findings and recommendations will be discussed with the ACO prior to issuance of the report.

c. Audit reports will be addressed to the activity requesting the audit with a copy to the ACO. Reports resulting from audits initiated by the auditor will be addressed to the ACO. A copy of the report will be provided to the affected program office(s), and the FLA(s), where applicable.

d. When an audit of a CFSR submission discloses that a loss is anticipated for a fixed-price contract, the auditor will ascertain whether the contractor is entitled to progress payments. If so, the auditor should make sure that the indicated rate of loss disclosed in the CFSR audit is appropriately applied by the contractor for purposes of computing its progress payment request.