



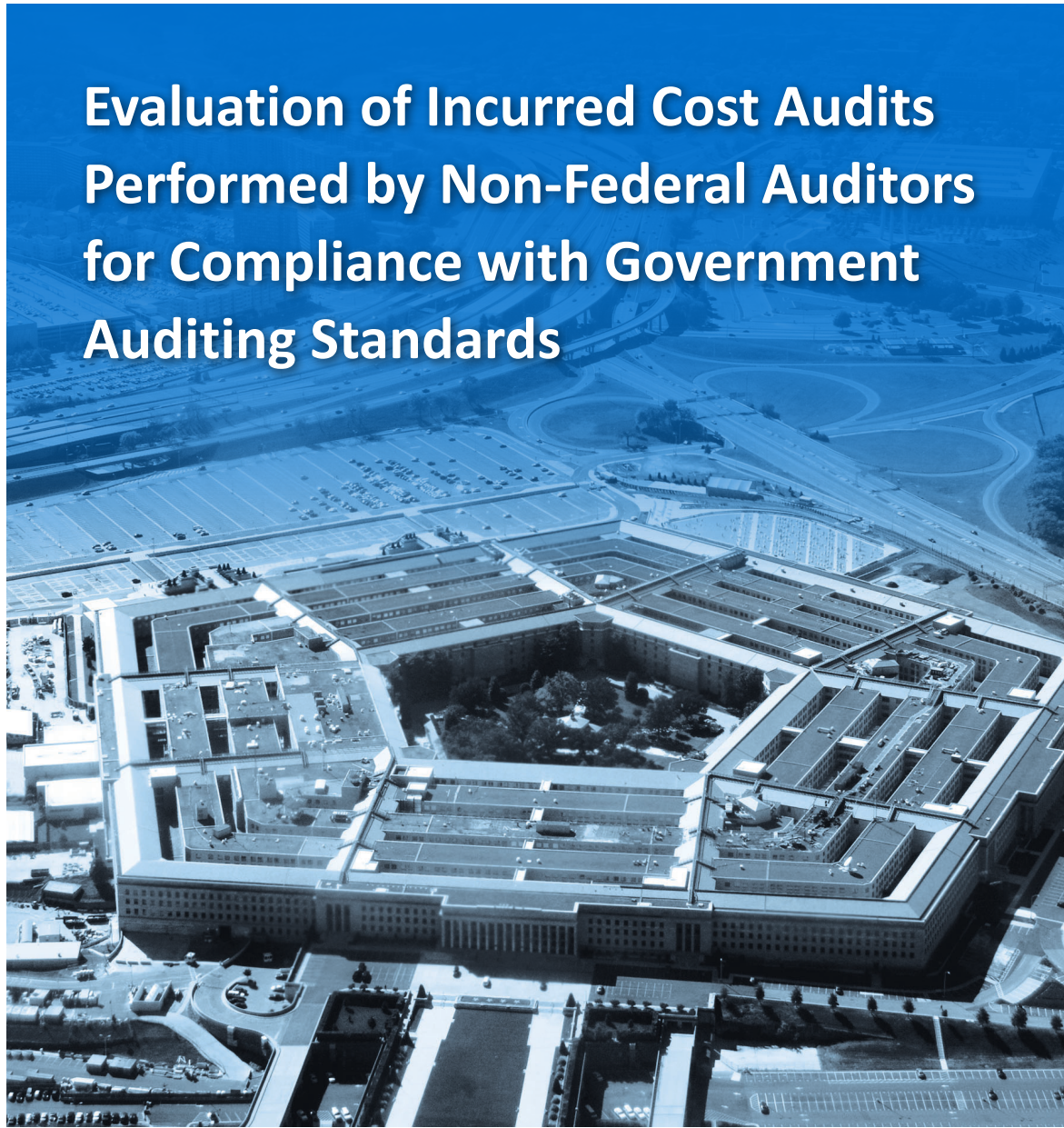
INSPECTOR GENERAL

U.S. Department of Defense

JANUARY 21, 2025



Evaluation of Incurred Cost Audits Performed by Non-Federal Auditors for Compliance with Government Auditing Standards



INDEPENDENCE ★ INTEGRITY ★ EXCELLENCE ★ TRANSPARENCY





Results in Brief

Evaluation of Incurred Cost Audits Performed by Non-Federal Auditors for Compliance with Government Auditing Standards

January 21, 2025

Objective

The objective of this evaluation was to determine whether non-Federal auditors complied with Government Auditing Standards and other professional standards when they performed audits of DoD contractor incurred costs.

Background

The Defense Contract Audit Agency (DCAA) performs audits of DoD contractors. To help eliminate a DCAA backlog of incurred cost audits, the FY 2018 National Defense Authorization Act required the use of non-Federal auditors to perform incurred cost audits of DoD contractors.

We evaluated a nonstatistical sample of 16 incurred cost audits performed by non-Federal auditors from October 1, 2018, through September 30, 2022, focusing on those audits that resulted in higher costs examined and lower costs questioned. We evaluated the sample to determine whether the audits complied with Government Auditing Standards and other professional auditing standards.

Findings

For 11 of 16 (69 percent) audits we reviewed, we identified noncompliances with Government Auditing Standards. We identified 34 total instances of noncompliance among the 11 audits where non-Federal auditors did not:

- obtain sufficient evidence to fully support their reported conclusions for 8 audits;

Findings (cont'd)

- use a sufficient sample methodology to support their conclusions for 4 audits;
- document the work they performed in sufficient detail for 11 audits; and
- make inquiries of management for 11 audits.

Recommendations

We recommend that the DCAA Director determine if the eight reports where the non-Federal auditors did not obtain sufficient evidence should be rescinded or revised.

In addition, we recommend that the DCAA Director, in coordination with the Defense Logistics Agency (DLA) Director, evaluate and make any necessary revisions to the performance work statements of all future contracts with non-Federal auditors to ensure that DCAA contracting officer's representatives have sufficient authority and responsibility to review non-Federal auditor work for compliance with Government Auditing Standards.

We also recommend that the DCAA Director, in coordination with the DLA Director, require non-Federal auditors to address compliance with Government Auditing Standards in their quality control plans.

Management Comments and Our Response

The DCAA Director and the DLA Director of Acquisition (the Directors) disagreed with our recommendations. The Directors' comments did not address the specifics of our recommendations; therefore, the recommendations are unresolved. We request that the Directors provide additional comments that describe the specific actions they will take to address the unresolved recommendations within 30 days of the final report.

Please see the Recommendations Table on the next page for the status of the recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Director, Defense Contract Audit Agency	1.a, 1.b, 2.a, 2.b, 2.c.1, 2.c.2, 3.a, 3.b, 3.c, 3.d, 3.e, 4.a, 4.b, 4.c, and 4.d	None	None
Director, Defense Logistics Agency	2.a, 2.b, 2.c.1, 2.c.2, 3.a, 3.b, 3.c, 3.d, and 3.e	None	None

Please provide Management Comments by February 21, 2025.

Note: The following categories are used to describe agency management's comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – The DoD OIG verified that the agreed upon corrective actions were implemented.



OFFICE OF INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

January 21, 2025

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Evaluation of Incurred Cost Audits Performed by Non-Federal Auditors for
Compliance with Government Auditing Standards (Report No. DODIG-2025-062)

This final report provides the results of the DoD Office of Inspector General's evaluation. We previously provided copies of the draft report and requested written comments on the recommendations. We considered management's comments on the draft report when preparing the final report. These comments are included in the report.

This report contains recommendations that are considered unresolved because the DCAA Director and the DLA Director of Acquisition disagreed and did not fully address the recommendations presented in the report.

Therefore, the recommendations remain open. We will track these recommendations until management has agreed to take actions that we determine to be sufficient to meet the intent of the recommendations and management officials submit adequate documentation showing that all agreed-upon actions are completed.

DoD Instruction 7650.03 requires that recommendations be resolved promptly. Therefore, please provide us within 30 days your response concerning specific actions in process or alternative corrective actions proposed on the recommendations. Send your response to [REDACTED]

If you have any questions, please contact [REDACTED].

FOR THE INSPECTOR GENERAL:

A handwritten signature in black ink, appearing to read "Randolph R. Stone", is positioned above the printed name.

Randolph R. Stone
Assistant Inspector General for Evaluations
Space, Intelligence, Engineering and Oversight

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Introduction

Objective

The objective of this evaluation was to determine whether non-Federal auditors complied with Government Auditing Standards and other professional standards when they performed audits of DoD contractor incurred costs.

Background

Non-Federal auditors are auditors who work for commercial audit firms rather than the Government. An incurred cost audit involves examining a DoD contractor's incurred cost proposal to express an opinion on whether the costs are allowable, reasonable, allocable, and comply with:

- contract terms,
- applicable Government acquisition regulations,
- Generally Accepted Accounting Principles, and
- Cost Accounting Standards.¹

As part of our evaluation, we nonstatistically selected 16 incurred cost audits that the non-Federal auditors completed from October 1, 2018, through September 30, 2022, focusing on those audits that resulted in higher costs examined and lower costs questioned by the non-Federal auditors. See Appendix A for a discussion of our scope and methodology, and Table 2 in Appendix B for a list of the 16 selected incurred cost audits.

Defense Contract Audit Agency Performs Audits of DoD Contractors

The Defense Contract Audit Agency (DCAA) performs audits of DoD contractors. In accordance with DoD Directive 5105.36, the DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer.² The DCAA performs several types of contract audits, including incurred cost audits. Incurred cost audits help to assess the allowability of a contractor's annual costs on DoD contracts. Each fiscal year, DoD contractors are required to submit an incurred cost proposal to the Government in

¹ Applicable Government acquisition regulations include the Federal Acquisition Regulation, which establishes uniform policies and procedures for acquiring goods and services by applicable executive agencies. Generally Accepted Accounting Principles are standards that establish financial accounting and reporting standards for public and private companies and non-for-profit organizations. Cost Accounting Standards are standards, rules, and regulations designed to ensure the uniformity and consistency of how costs charged to covered Government contracts are measured, assigned to accounting periods, calculated, allocated, and reported.

² DoD Directive 5105.36, "Defense Contract Audit Agency," December 1, 2021.

accordance with the Federal Acquisition Regulation (FAR) clause contained in their contracts.³ The proposal reflects the costs that the contractor has charged on Government contracts during its fiscal year. In FY 2011, the DCAA had a backlog of approximately 21,000 incurred cost audits that were awaiting completion. The DCAA considers audits older than 2 fiscal years to be backlogged. By FY 2017, the DCAA had significantly reduced its incurred cost audit backlog from 21,000 to 2,860.

The National Defense Authorization Act Authorized the Use of Non-Federal Auditors to Perform the DoD Contractor Incurred Cost Audits

Section 803 of the FY 2018 National Defense Authorization Act required the use of non-Federal auditors to in part eliminate any backlog of DCAA incurred cost audits by October 1, 2020, and ensure that incurred cost audits are completed not later than one year after the date of receipt of a qualified incurred cost proposal.⁴ From FY 2019 through FY 2023, the DCAA reported to Congress that 3,526 incurred cost audits were completed on \$922.9 billion in incurred DoD contractor costs. Of the 3,526 audits, non-Federal auditors completed 486 audits covering \$30.6 billion in incurred costs.

The FY 2018 National Defense Authorization Act requires that non-Federal auditors conduct the incurred cost audits in accordance with Government Auditing Standards. Government Auditing Standards are professional standards developed by the Government Accountability Office that provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence.

Additionally, the DoD contracts with the non-Federal auditors require that they complete the audits as examinations.⁵ As a result, the non-Federal auditors must also conduct the audits in accordance with the Statements on Standards for Attestation Engagements.⁶ The Statements on Standards for Attestation Engagements are professional standards issued by the American Institute of Certified Public Accountants Auditing Standards Board to provide performance and reporting requirements and guidance for all examinations. Government Auditing Standards incorporates the Statements on Standards for Attestation Engagements

³ FAR Part 52, "Solicitation Provisions and Contract Clauses," Subpart 52.2, "Text of Provisions and Clauses," Section 52.216-7, "Allowable Cost and Payment," Subsection 52.216-7(d)(2).

⁴ Public Law 115-91, "The National Defense Authorization Act for Fiscal Year 2018," section 803, "Performance of Incurred Cost Audits."

⁵ Examinations are a type of audit where the auditor obtains reasonable assurance that the subject matter is fairly stated and in compliance with criteria (such as the contract terms).

⁶ Attestation engagements are audits conducted in compliance with the attestation standards. One of the four types of attestation engagements is an examination.

standards by reference. In addition, the Inspector General Act of 1978 and DoD Directive 5106.01 state that the DoD OIG is responsible for overseeing work performed by non-Federal auditors to ensure it complies with Government Auditing Standards.

The Defense Logistics Agency Provides Acquisition Support to the Defense Contract Audit Agency

The Defense Logistics Agency (DLA) provides acquisition support to the DCAA when using non-Federal auditors to perform DoD contractor incurred cost audits. The DLA's overall mission involves managing the global supply chain for the Army, Navy, Air Force, Marine Corps, Space Force, combatant commands, other Federal agencies, and partner and allied nations. Before a contract award, a DLA contracting officer obtains bids from qualified non-Federal auditors to perform DoD contractor incurred cost audits. The DLA contracting officer then awards the contracts to the selected non-Federal auditors on the DCAA's behalf. The DLA contracting officer executes a contract with each non-Federal auditor based on the technical requirements that the DCAA establishes.

The DCAA Establishes the Technical Requirements and Serves as Contracting Officer's Representative

In coordination with the DLA contracting officer, the DCAA establishes the technical requirements of the contracts with the non-Federal auditors and serves as contracting officer's representative (COR) after a contract award. The contracts include a performance work statement (PWS) that describes the performance objectives and standards expected of the non-Federal auditors. The DCAA prepares the PWS and is required to send the PWS to the DoD OIG for review in accordance with DoD Manual 7600.07. The DoD OIG reviews the proposed PWS to ensure that it requires the non-Federal auditor to:

- comply with Government Auditing Standards;
- provide the non-Federal auditor's most recent peer review report;
- confirm the non-Federal auditor's independence;
- refer instances of fraud;
- address and provide the final report to the appropriate parties; and
- preserve the workpapers for at least 3 years.⁷

⁷ DoD Manual 7600.07, "DoD Audit Manual," August 3, 2015.

The DoD OIG review is limited to determining if the PWS complies with these six listed requirements. If necessary, the DoD OIG will make recommendations to revise the PWS for complying with the DoD Manual 7600.07 requirements. However, the DoD OIG does not approve the PWS, and the DCAA is not required to implement the DoD OIG recommendations. According to DoD Manual 7600.07, if the DCAA does not implement the DoD OIG recommendations, the DCAA must notify the DoD OIG what recommendations were not followed and explain why. Also, the DCAA must notify the DLA contracting officer. In addition to preparing the PWS before a contract award, the DCAA establishes a technical evaluation team that receives, evaluates, and selects non-Federal auditor bids for performing the DoD contractor incurred cost audits.

After a contract award, a DCAA official serves as the COR. Section 4.5.1.3 of the PWS requires that the DCAA CORs provide the DLA contracting officers with information on the performance of the non-Federal auditors. According to the PWS, section 1, "Definitions," the DCAA CORs are required to ensure that the non-Federal auditors complete their work in accordance with the terms of the contract. In addition, section 4.5.1.3 of the PWS states that the DCAA CORs are responsible for monitoring, inspecting, reporting, and making recommendations to the DLA contracting officers on the quality of work performed by the non-Federal auditors. If non-Federal auditor performance does not comply with the contract's quality requirements, the DCAA COR is required to advise the DLA contracting officer of the noncompliances. Additionally, PWS section 4.1, "Inspection and Acceptance," states in part that the DCAA CORs are responsible for the inspection and acceptance of all services provided by the non-Federal auditors and requires that the DCAA CORs approve and accept the non-Federal auditor workpapers and audit report.

Finding

We Identified Noncompliances with Government Auditing Standards for 11 of 16 Audits We Reviewed

For 11 of 16 (69 percent) audits we reviewed, we identified noncompliances with Government Auditing Standards. We identified two or more noncompliances for each of the 11 audits. In total, we identified the following 34 instances among the 11 audits where the non-Federal auditors did not comply with Government Auditing Standards.

- For eight audits, the non-Federal auditors did not obtain sufficient evidence to fully support their conclusions in the incurred cost audit reports in accordance with Government Auditing Standard (GAS) 1.18a, “Examination.”⁸
- For four audits, the non-Federal auditors did not use a sufficient sample methodology to support their conclusions in the incurred cost audit reports, as required by Statements on Standards for Attestation Engagements number 18 (AT-C) §205A.31, “Sampling.”
- For 11 audits, the non-Federal auditors did not sufficiently document the work they performed in accordance with GAS 7.34, “Examination Engagement Documentation.”⁹
- For 11 audits, the non-Federal auditors did not make required inquiries with the DoD contractor’s management in accordance with GAS 7.13, “Results of Previous Engagements,” or GAS 7.14, “Investigations or Legal Proceedings.”¹⁰

We identified the following four areas that should be improved to help reduce future noncompliances with Government Auditing Standards.

- DCAA contracting officer’s representatives (CORs) should improve their contract oversight by reviewing the non-Federal auditors’ work for compliance with Government Auditing Standards;
- The performance work statement (PWS) should require non-Federal auditors to submit their sample plans for the DCAA COR’s review before they complete fieldwork or deliver their report;

⁸ The GAS 1.18a requirement in the 2018 Government Auditing Standards was GAS 2.09a, “Examination,” in the 2011 Government Auditing Standards.

⁹ The GAS 7.34 requirement in the 2018 Government Auditing Standards was GAS 5.16a, “Examination Engagement Documentation,” in the 2011 Government Auditing Standards.

¹⁰ The GAS 7.13, “Results of Previous Engagements,” requirement in the 2018 Government Auditing Standards was GAS 5.06, “Previous Audits and Attestation Engagements,” in the 2011 Government Auditing Standards. The GAS 7.14 requirement in the 2018 Government Auditing Standards was GAS 5.10, “Fraud, Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements, and Abuse,” in the 2011 Government Auditing Standards.

- DCAA CORs should not rely on the non-Federal auditor quality control plans for determining non-Federal auditor compliance with Government Auditing Standards; and
- To review the non-Federal auditors' work, DCAA CORs should improve their quality assurance surveillance plan checklist and supplemental checklist by including questions on compliance with Government Auditing Standards.¹¹

As a result of the noncompliances, the incurred cost audit results for the 11 audits may be unreliable to support that the DoD contractors' proposed incurred costs comply with contract terms, applicable Government regulations, and Cost Accounting Standards.

For 11 of 16 Audits, We Identified Noncompliances with Government Auditing Standards

For 11 of 16 audits we reviewed, we identified noncompliances with Government Auditing Standards. We identified two or more noncompliances for each of the 11 audits. In total, we identified 34 noncompliances among the 11 audits where non-Federal auditors did not:

- obtain sufficient evidence to fully support their reported conclusions for 8 of 16 audits,
- use a sufficient sample methodology to support their conclusions for 4 of 16 audits,
- sufficiently document the work they performed for 11 of 16 audits, and
- make required inquiries with the DoD contractor's management for 11 of 16 audits.

The Non-Federal Auditors Did Not Obtain Sufficient Evidence for 8 of 16 Audits

For 8 of 16 audits, the non-Federal auditors did not obtain sufficient evidence to fully support their reported conclusions in accordance with GAS 1.18a. GAS 1.18a requires auditors to obtain sufficient appropriate evidence to enable the auditors to draw reasonable conclusions on which to base their opinion. Table 3 in Appendix C identifies the eight audits where the non-Federal auditors did not obtain sufficient evidence to fully support their conclusions in the incurred cost audit reports.

¹¹ The quality control plan details how the non-Federal auditor plans to comply with the technical requirements of the contract, including compliance with Government Auditing Standards. The quality assurance surveillance plan checklist documents the DCAA COR's review of the non-Federal auditor's audit for compliance with the requirements of the PWS.

For example, for audit report number ending in 2020M10100002, the non-Federal auditor reported its conclusions that the DoD contractor's \$1.4 million in proposed incurred costs for equipment rentals charged to two specific contracts were allowable and the auditor did not identify noncompliances with the DoD contractor's proposed costs. However, based on our review of the workpapers and discussions with the non-Federal auditor, we determined that the non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of the costs. For a cost to be allowable, it must be allocable to the contract in accordance with FAR 31.201-4, "Determining Allocability."¹² FAR 31.201-4 states that a cost is allocable if the cost is incurred specifically for the contract. The non-Federal auditor stated that they obtained invoices and journal entries associated with the selected equipment rental transactions. An invoice is a document provided by the seller relating to a sale of goods or services, which states the product purchased, quantities purchased, and price of the product. A journal entry is an accounting record of business transactions that includes the transaction amount and relevant accounts. However, neither invoices nor journal entries obtained by the non-Federal auditors included information that was sufficient to determine whether the costs were allocable to the two contracts. Therefore, the non-Federal auditor did not determine if the equipment was necessary for, and allocable to, the contract. If the non-Federal auditor does not examine costs that are charged to a Government contract for allocability, the DoD contractor may be reimbursed for costs that did not benefit the Government contract.

In another example, for audit report number ending in 2020S10100003, the non-Federal auditor reported its conclusion that the DoD contractor's \$92 million in proposed incurred direct labor costs were allowable. However, based on our review of the workpapers and discussions with the non-Federal auditor, we determined that the non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of the direct labor costs. For a cost to be allowable, it must be reasonable in accordance with FAR 31.201-3, "Determining Reasonableness."¹³ FAR 31.201-3 states that a cost is reasonable if it does not exceed the amount that would be incurred by a prudent person in the conduct of a competitive business. The non-Federal auditor stated that they tested for

¹² Government Auditing Standards require the auditors to provide reasonable assurance that the subject matter is fairly stated and in compliance with criteria. The criteria for incurred cost audits is allowability. The FAR is the governing authority for establishing the allowability of contract costs. FAR Part 31, "Contract Cost Principles and Procedures," Subpart 31.2, "Contracts with Commercial Organizations," Section 31.201, "General," Subsection 31.201-4, "Determining Allocability."

¹³ FAR Part 31, "Contract Cost Principles and Procedures," Subpart 31.2, "Contracts with Commercial Organizations," Section 31.201, "General," Subsection 31.201-3, "Determining Reasonableness."

reasonableness by verifying that the employees' timesheets were approved. However, the non-Federal auditor's verification of timesheet approval was not sufficient to establish that the direct labor costs were reasonable. The non-Federal auditor had several different options for appropriately establishing the reasonableness of direct labor costs. For example, the non-Federal auditors could have compared average proposed labor costs to those published in salary surveys for similar jobs or established in labor agreements. If the non-Federal auditor does not appropriately examine costs for reasonableness, they may not detect costs that the Government has overpaid for goods and services provided by the DoD contractor.

The Non-Federal Auditors Did Not Use a Sufficient Sample Methodology for 4 of 16 Audits

For 4 of 16 audits, the non-Federal auditors did not use a sufficient sample methodology as a basis for their reported conclusions. Statements on Standards for Attestation Engagements number 18 (AT-C) §205A.31, which is incorporated in Government Auditing Standards, requires that if auditors select a sample for transaction testing, the sample size must be sufficient to reduce risk and must be based on a relevant universe to provide a reasonable basis for conclusions about the universe.¹⁴ Table 3 in Appendix C identifies the four audits where the non-Federal auditors did not use a sufficient sample methodology.

For example, for audit report number ending in 2018K10100732, the non-Federal auditor did not document in the workpapers, and could not adequately explain to us, why the sample size was sufficient to reduce risk of significant noncompliances in accordance with AT-C §205A.31. For direct and indirect non-labor costs, the non-Federal auditor selected 59 transactions across 23 accounts. The non-Federal auditor based the sample size on the expectation that they would not identify any noncompliances among the sampled transactions. According to the workpapers, if the auditor found any noncompliances, the sample methodology required a sample size greater than 59 transactions. After testing the 59 transactions, the non-Federal auditor identified three noncompliances, but they did not increase the sample size in accordance with the sample methodology. Additionally, the non-Federal auditor did not explain in their workpapers why the sample size of 59 transactions was sufficient under the circumstances.

¹⁴ Government Auditing Standards incorporates the Statements on Standards for Attestation Engagements standards by reference.

In another example, based on our review the workpapers and discussion with the non-Federal auditor, we determined that the non-Federal auditor for the audit report number ending in 2019R10100001 did not select a sample based on a relevant universe as required by AT-C §205A.31. The non-Federal auditor did not select a sample of computing costs from a universe that tied to the universe of computing costs in the DoD contractor's incurred cost proposal. Specifically, the non-Federal auditor selected a sample from a universe of computing costs that totaled \$1.9 million, even though the computing costs in the DoD contractor's incurred cost proposal totaled \$5 million. The non-Federal auditor did not explain the difference in the workpapers. The non-Federal auditor explained to us that the \$1.9 million represented the three largest contracts. However, this does not explain why the auditors only sampled from a universe \$1.9 million of computing costs instead of the total claimed computing costs universe of \$5 million.

The Non-Federal Auditors Did Not Sufficiently Document the Work They Performed for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not sufficiently document the work they performed in accordance with Government Auditing Standards. GAS 7.34 requires that auditors prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the examination engagement, to understand the procedures performed, the evidence obtained, and the conclusions reached. Table 3 in Appendix C identifies the 11 audits where the non-Federal auditors did not sufficiently document the work they performed.

For example, for audit report number ending in 2020J10100007, the non-Federal auditor did not sufficiently document their calculations for assessing the materiality of the audit as a whole, individual accounts, or transactions within accounts. Materiality calculations are important in determining which accounts and transactions can have a significant effect on the audit objective. We had to hold extensive discussions with the non-Federal auditor who explained that the calculation was based on factors provided by a third-party vendor. The factors provided by the vendor were not documented in the workpapers. Based on our discussions with the non-Federal auditor, we determined the auditor appropriately considered materiality; however, they did not adequately document their basis for assessing materiality in the workpapers.

In another example, for audit report number ending in 2018A10100008, the non-Federal auditor did not adequately document the work they performed to support the conclusions they reached. We identified workpapers where the non-Federal auditor did not adequately explain how they determined that the risk of significant noncompliances was low. For instance, in one of the workpapers, the non-Federal auditor concluded that previous audits did not affect the current audit. However, the auditor did not document how they made their conclusion. In addition, the non-Federal auditor documented their understanding of an audit lead from a previous audit that related to evidence concerns with travel and subcontract costs.¹⁵ Also, the non-Federal auditor did not document how the audit lead affected the scope of their audit. Finally, the non-Federal auditor could not adequately explain why they assessed the risk of significant noncompliances as low in light of the audit lead.

The Non-Federal Auditors Did Not Make Inquiries with the DoD Contractor's Management for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not make inquiries with the DoD contractor's management as required by GAS 7.13 or GAS 7.14. GAS 7.13 requires that auditors ask the contractor's management to identify previous audits, attestation engagements, and other studies that directly relate to the subject matter or a statement about the subject matter of the examination engagement, including whether related recommendations were implemented. GAS 7.14 requires that auditors inquire with the contractor's management on whether any investigations or legal proceedings may affect the audit.

In total, we found 14 noncompliances among the 11 audits where the non-Federal auditors did not comply with GAS 7.13 or GAS 7.14. Specifically, for 4 of 11 audits, the non-Federal auditors did not make inquiries with the DoD contractor's management about corrective actions made in response to previous audit findings, as required by GAS 7.13. For 10 of 11 audits, the non-Federal auditors did not make inquiries with the DoD contractor's management about investigations or legal proceedings, as required by GAS 7.14. Table 1 identifies the 14 noncompliances among the 11 audits where the non-Federal auditors did not make the required management inquiries.

¹⁵ An audit lead is an issue identified by an auditor in the current or previous audit that may require appropriate follow-up in future audits.

Table 1. Audits Where Non-Federal Auditors Did Not Make Inquiries with DoD Contractor's Management

Count	Audit Report Number (Ending in)	Noncompliances		Total Number of Noncompliances
		GAS 7.13	GAS 7.14	
1	2019J10100001	X		1
2	2018A10100008	X	X	2
3	2020J10100007		X	1
4	2020S10100003		X	1
5	2019P10100003		X	1
6	2019R10100001	X	X	2
7	2020R10100011		X	1
8	2020A10100005		X	1
9	2020M10100002		X	1
10	2020K10100432		X	1
11	2018K10100732	X	X	2
Number of Noncompliances		4	10	14

Source: The DoD OIG, based on data received from the DCAA.

For example, for audit report number ending in 2019R10100001, the non-Federal auditor did not make an inquiry related to investigations or legal proceedings as required by GAS 7.14. The non-Federal auditor explained to us that they placed reliance on the management representation letter as evidence of the inquiry related to investigations or legal proceedings. A management representation letter is a statement from the DoD contractor provided at the end of the audit. In the management representation letter, the DoD contractor affirmed its responsibility for preparing the incurred cost submission and confirmed that it provided all relevant information requested by the non-Federal auditor. However, the management representation letter did not specifically state whether any open and relevant investigations or legal proceedings occurred.

In another example, for audit report number ending in 2018K10100732, the non-Federal auditor did not ask management if any previous audit findings occurred that related to the audit in accordance with GAS 7.13. The non-Federal auditor discovered that the DCAA had questioned \$2.7 million of labor costs in a previous audit because the employees did not meet the contractual labor qualifications. However, the non-Federal auditor did not ask the DoD contractor's management if they had taken any corrective actions because the previously questioned labor costs in accordance with GAS 7.13. In addition, the non-Federal auditor did not design test to determine if the previous audit finding still existed.

Four Areas that Should Be Improved to Help Reduce Future Noncompliances with Government Auditing Standards

We identified the following four areas that should be improved to help reduce future noncompliances with Government Auditing Standards.

- DCAA CORs should improve their contract oversight by reviewing the non-Federal auditors' work for compliance with Government Auditing Standards.
- The PWS should require non-Federal auditors to submit their sample plans for the DCAA COR's review before they complete fieldwork or deliver the report.
- DCAA CORs should not rely on the non-Federal auditor quality control plans for determining compliance with Government Auditing Standards.
- DCAA CORs should improve their quality assurance surveillance plan checklist and supplemental checklist by including questions on compliance with Government Auditing Standards.

DCAA CORs Should Improve Their Contract Oversight by Reviewing the Non-Federal Auditors' Work

The DCAA CORs should improve their contract oversight by reviewing the non-Federal auditors' work for compliance with Government Auditing Standards. The DCAA CORs did not review the non-Federal auditors' workpapers for compliance with Government Auditing Standards before approving or accepting the non-Federal audits.

A DCAA representative told us that section 3.4.1.3 of the PWS does not give the DCAA COR the authority or responsibility to review the non-Federal auditors' work for compliance with Government Auditing Standards.¹⁶ Although the authorities and responsibilities may not be specifically addressed in section 3.4.1.3, we identified the following other sections of the PWS that do address the authorities and responsibilities of the non-Federal auditor and the DCAA COR for ensuring compliance with Government Auditing Standards.

- Section 1, "Definitions," states that the DCAA COR assists the DLA contracting officer with monitoring technical requirements and ensuring non-Federal auditors meet all required performance parameters.

¹⁶ Section 3.4.1.3, "Delivery the Final Working Paper Package," provides the non-Federal auditors with instructions for the submission of workpapers to the DCAA COR.

- Section 3.1, “General,” and section 3.4.1.1, “Planning and Performing the Audit,” state that the non-Federal auditor must perform the audits in accordance with Government Auditing Standards.
- Section 4.5.1.3, “Surveillance Schedule,” states that the DCAA CORs are responsible for monitoring, inspecting, reporting on, and making recommendations to the DLA contracting officers on the quality of work performed by the non-Federal auditors.

The PWS Should Require the Non-Federal Auditors to Submit Their Sample Plans for Review Before They Deliver the Report

The PWS should require non-Federal auditors to submit their sample plans for the DCAA COR’s review before the non-Federal auditors complete fieldwork and deliver the report. Specifically, section 3.4.1.1, “Planning and Performing the Audit,” and section 4.4, “Deliverables and Deliverable Schedule,” of the PWS does not require that the non-Federal auditors submit their sample plans until they have completed their fieldwork and delivered the workpapers and report. In contrast, the PWS does require that the non-Federal auditors deliver the audit plan before they complete fieldwork.

As a result, the PWS did not give the DCAA CORs for the 16 audits adequate time to conduct a meaningful review of the sample plans. If the DCAA CORs had received the sample plans before fieldwork began for the audits we selected, they may have identified the sample plan deficiencies we found and corrected them before the non-Federal auditors completed their fieldwork. Therefore, the PWS should be updated to require that the non-Federal auditor submit sample plans with their audit plan, which the non-Federal auditor is required to submit before fieldwork begins.

DCAA CORs Should Not Rely on the Non-Federal Auditors’ Quality Control Plans for Determining Compliance

DCAA CORs should not rely on the non-Federal auditors’ quality control plans for determining compliance with Government Auditing Standards. The DCAA CORs for the 16 audits used the quality control plans as a basis for not reviewing the non-Federal auditor work for compliance with Government Auditing Standards. The quality control plan details how the non-Federal auditor plans to comply with the technical requirements of the contract, including compliance with Government Auditing Standards. A DCAA representative told us that the DCAA CORs for the

16 audits we selected had reviewed the quality control plans of the non-Federal auditors during the selection process to reduce the risk of non-Federal auditors not complying with Government Auditing Standards.

However, we determined that the DCAA COR's review of the quality control plans for the 16 audits we reviewed was not sufficient to solely rely upon for determining compliance with Government Auditing Standards. For the 16 audits, the non-Federal auditors' quality control plans did not address how the non-Federal auditors planned to comply with the following Government Auditing Standards requirements.

- The GAS 1.18a requirement to obtain sufficient evidence to support their conclusions.
- The GAS 7.13 and GAS 7.14 requirements to perform management inquiries.
- The AT-C §205A.31 requirement to select a sufficient sample that supports the conclusions.

In addition, for 15 of 16 audits, the quality control plans did not address the GAS 7.34 requirement to document the work in sufficient detail.

A quality control plan that comprehensively addresses the key Government Auditing Standards requirements should help to reduce the risk of non-Federal auditors not complying with Government Auditing Standards. However, a comprehensive quality control plan should not be used as a basis to eliminate the DCAA COR's review of the non-Federal auditors' actual work products for compliance with the Government Auditing Standards.

DCAA CORs Should Improve Their Quality Assurance Surveillance Plan Checklist and Supplemental Checklist

DCAA CORs should improve their quality assurance surveillance plan checklist and supplemental checklist by including questions on compliance with Government Auditing Standards. DCAA CORs use the checklists to help them review the non-Federal auditor's work. However, the checklists do not include questions related to determining compliance with Government Auditing Standards. The quality assurance surveillance plan checklist documents the DCAA COR's review of the non-Federal auditor's audit for compliance with the requirements of the PWS. The supplemental checklist documents the DCAA COR's review results of the non-Federal auditor workpapers.

Although the DCAA CORs used both the quality assurance surveillance plan checklist and supplemental checklist for reviewing the non-Federal audits, a DCAA COR told us that the contract with the non-Federal auditors only required that DCAA CORs use the quality assurance surveillance plan. We reviewed the checklists that the DCAA CORs completed for all 16 selected audits, which did not identify any noncompliances with Government Auditing Standards. In some instances, the DCAA CORs noted in the supplemental checklists that the workpapers met the requirements of the PWS, but that the workpapers could be improved. For example, the DCAA COR for audit report ending 2018K10100732 documented in the checklist that the non-Federal auditor's documentation and transaction testing met the requirements of the PWS, but that it could be improved to meet "DCAA standards."

The DCAA COR stated that because the supplemental checklist was not required, the findings documented in the checklist were beyond the scope of their authority and not a requirement of the PWS. The DCAA COR also stated that, although they furnished a copy of the quality assurance surveillance plan checklist and supplemental checklist to the DLA contracting officer, they did not discuss any noncompliances with the DLA contracting officer. If the DCAA CORs do not address the noncompliances in the checklist or otherwise communicate them to the DLA contracting officer, the Government may receive audits from non-Federal auditors that do not comply with Government Auditing Standards. The DCAA CORs should communicate noncompliances with Government Auditing Standards to the non-Federal auditors and DLA contracting officers. The DCAA COR designation letter authorizes the DCAA COR to:

- inspect the work of the non-Federal auditor to assure that their performance is in accordance with the contract requirements;
- promptly report to the DLA contracting officer, in writing, any performance issues by the non-Federal auditor; and
- when possible, but without change to the existing contract, work with the non-Federal auditor and DLA contracting officer to resolve issues.¹⁷

The supplemental checklists did not sufficiently include questions related to determining compliance with Government Auditing Standards. The supplemental checklists that the DCAA CORs completed for the 16 audits included a question related to determining whether the non-Federal auditors' workpapers complied with the requirement to document their work in sufficient detail as required by GAS 7.34. However, neither the supplemental checklists nor the quality

¹⁷ A contracting officer's representative designation letter specifies their duties and responsibilities for a specific contract.

assurance surveillance plan checklists included questions related to the following three areas where we identified instances of noncompliance with Government Auditing Standards:

- the sufficiency of evidence that the auditors obtained to support the reported conclusions as required by GAS 1.18a;
- the sufficiency of sample methodology that the auditors used to comply with AT-C §205A.31; and
- the management inquiries that the auditors are required to make in accordance with GAS 7.13 and 7.14.

Adding these areas to the supplemental checklist or the quality assurance surveillance plan checklist should help to improve the DCAA CORs' detection and correction of these types of noncompliances before report issuance.

The Incurred Cost Audit Results May Be Unreliable for 11 of 16 Audits

As a result of non-Federal auditors not complying with Government Auditing Standards, the incurred cost audit results for 11 of 16 audits may be unreliable. In addition, by not fully complying with Government Auditing Standards, the non-Federal auditors risked:

- accepting a significant amount of incurred costs that may be unallowable on DoD contracts; and
- affecting an investigation or legal proceeding and not properly assessing areas of increased risk for unallowable costs.

Non-Federal Auditor Noncompliances Risked the Acceptance of a Significant Amount of Incurred Costs that Were Unallowable

By not fully obtaining sufficient evidence for 8 of 16 audits or selecting a sufficient sample for 4 of 16 audits we reviewed, the non-Federal auditors may not have questioned up to \$940 million in unallowable DoD contractor incurred costs that were charged to Government contracts.¹⁸ In turn, the DoD contracting officers may have inappropriately accepted unallowable costs that the non-Federal auditor did not question.

¹⁸ The \$940 million of potential unallowable costs represent the total costs within DoD cost accounts where the non-Federal auditors did not gather sufficient evidence to support their opinion in the eight incurred cost audit reports.

In addition, unallowable costs not questioned by non-Federal auditors may have been subject to penalty. FAR 52.242-3(b) states that contractors that include unallowable indirect costs in an indirect cost rate proposal may be subject to penalties.¹⁹ Therefore, if the non-Federal auditors had obtained sufficient and appropriate evidence, contracting officers may have been able to assess penalties in addition to recouping the unallowable costs. Also, if the non-Federal auditors selected a sample for testing that did not accurately represent the universe of proposed incurred costs, the non-Federal auditors may not have detected unallowable costs that were present in the incurred cost proposal.

Non-Federal Auditors Risked Impacting an Investigation or Legal Proceeding and Improperly Assessing Audit Risk

By not making sufficient management inquiries for 10 of the 16 audits, the non-Federal auditors may have affected an ongoing investigation or legal proceeding. For example, the findings and conclusions of the non-Federal auditors may have affected an ongoing investigation if they accepted costs that were the subject of the investigation.

In addition, non-Federal auditors may not have properly assessed risk on 4 of the 16 audits because they did not make management inquiries of previous audit findings. For example, if the non-Federal auditors had appropriately considered previous audit findings, they may have identified higher risk areas where costs had been previously questioned as unallowable or non-compliant with contract terms.

Management Comments on the Finding and Our Response

The DCAA Director provided management comments on the eight noncompliance examples reported from the 11 audits. Summaries of management comments on the eight noncompliance examples reported, and our response, are in Appendix D. In addition, the DCAA Director provided supplementary comments on the 34 instances of noncompliances among the 11 audits. Summaries of the 34 instances of noncompliances, supplementary management comments, and our response are in Appendix E.

¹⁹ FAR Part 52 "Solicitation Provisions and Contract Clauses," Subpart 52.2, "Text of Provisions and Clauses," Section 52.242-3, "Penalties for Unallowable Costs," Subsection 52.242-3(b).

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Defense Contract Audit Agency Director:

- a. **Determine whether the following eight audit reports that the non-Federal auditors issued without sufficient evidence should be rescinded or revised.**
 1. **2019J10100001**
 2. **2018A10100008**
 3. **2020S10100003**
 4. **2019P10100003**
 5. **2019R10100001**
 6. **2020M10100002**
 7. **2018K10100732**
 8. **2020K10100432**
- b. **Document the results of the determination and provide notification to the DoD contracting officers responsible for acting on the incurred cost audits.**

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the DoD OIG did not demonstrate that five of the eight audits lacked sufficient evidence. For the other three audits, the Director stated that the non-Federal auditors could have documented their work better, but the documentation issues did not meet the requirement of insufficient evidence that would result in withdrawing the audit reports.

Our Response

The DCAA Director's comments partially addressed Recommendation 1; therefore, the recommendation is unresolved. The Director stated that the eight audits do not need to be withdrawn or revised. However, the Director's comments do not demonstrate that the DCAA conducted a comprehensive review of the eight audits. In addition, for the eight audits, the Director did not explain why the evidence the non-Federal auditors obtained was sufficient to support the reported conclusions that costs were allowable, allocable, and reasonable. We request that the DCAA Director provide additional comments within 30 days of the final report to describe the DCAA's comprehensive review of the eight audits and the specific reasons for determining if the non-Federal auditors obtained sufficient evidence.

Recommendation 2

We recommend that the Defense Contract Audit Agency Director, in coordination with the Defense Logistics Agency Director:

- a. Review the performance work statement for the contracts with the non-Federal auditors to determine if it provides Defense Contract Audit Agency contracting officer's representatives with clear guidance for reviewing the non-Federal auditor work for compliance with Government Auditing Standards.**
- b. Based on the results of the review in Recommendation 2.a, develop and implement a plan to make any necessary revisions to the performance work statement for future contracts with the non-Federal auditors, to ensure that Defense Contract Audit Agency contracting officer's representatives possess the authority and responsibility to review non-Federal auditor work for compliance with Government Auditing Standards before the DoD approves or accepts non-Federal audit results.**
- c. Develop and implement a plan to revise the performance work statement in future contracts with the non-Federal auditors to require that:**
 - 1. Non-Federal auditors submit the sample plans before fieldwork begins, along with the audit plan, and**
 - 2. The Defense Contract Audit Agency contracting officer's representatives review non-the Federal auditor sample plans for compliance with Government Auditing Standards.**

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the DoD OIG determined the PWS already requires compliance with Government Auditing Standards. In addition, the Director stated that Recommendation 2 would result in the DCAA COR inserting themselves in the audit process of the non-Federal auditors.

Also, the Director stated that the DoD OIG should consider the following five factors:

- The DoD OIG did not demonstrate a systemic problem. The Director stated that the DoD OIG sampled 4.3 percent of audits and identified noncompliances with 1.7 percent of workpapers.
- Recommendation 2 is excessive because of the small dollar amount awarded to the non-Federal auditors. Additionally, the DCAA Director considered the risk to the Government associated with the non-Federal audits to be low.
- Implementing Recommendation 2 would result in an increased cost to taxpayers.

- Implementing Recommendation 2 would have an adverse effect on small business non-Federal auditors.
- The DCAA has processes in place before a contract award to assess the qualifications of the non-Federal auditors and after a contract award to ensure the timeliness of non-Federal auditors' work. In addition, the DCAA Director stated that the processes are functioning as intended.

Our Response

The DCAA Director's comments did not address the specifics of Recommendation 2; therefore, the recommendation is unresolved. We made Recommendations 2a and 2b because the DCAA CORs stated that the PWS did not give them the authority to review the non-Federal auditors' work for compliance with Government Auditing Standards.

Recommendation 2 does not result in the DCAA CORs inserting themselves into the audit process of the non-Federal auditors. Recommendation 2 is consistent with the requirements of the contract. Section 4.5.1.3, "Surveillance Schedule," of the contract states that the DCAA CORs are responsible for monitoring, inspecting, reporting on, and making, recommendations to the DLA contracting officers on the quality of work performed by the non-Federal auditors.

In response to the five factors outlined by the DCAA Director, we determined that Recommendation 2 is warranted for the following reasons.

- Our findings demonstrate the existence of significant noncompliances that warrant corrective action by the DCAA and the DLA. We disagree that the sample size was small in comparison to the size of the non-Federal auditor program. Our sample represents a reasonable cross-section of the 369 audits that the non-Federal auditors completed and at least one audit from each of the nine non-Federal auditors. Additionally, because we used a risk-based sampling approach, our sample encompasses 35 percent of the costs examined by non-Federal auditors during the 369 audits. Therefore, the evidence we gathered from our sample was sufficient, competent, and relevant to lead a reasonable person to sustain our findings, conclusions, and recommendations.

Although the DCAA Director stated that only 1.7 percent of workpapers contained a noncompliance, the Director did not provide evidence to support the percentage. In addition, the percentage may be misleading because workpapers typically include a significant number of documents that do not form the basis for an auditor's rationale or conclusions.

- We disagree that Recommendation 2 is excessive and not commensurate with the overall risk to the Government. From FY 2020 through FY 2022, non-Federal auditors examined \$24.4 billion in proposed DoD contractor incurred costs. Additionally, we identified \$940 million in costs associated with the 16 selected audits where the non-Federal auditors did not obtain sufficient evidence to support their conclusions that the costs were allowable, allocable, and reasonable.
- The DCAA Director did not provide evidence that Recommendation 2 would result in increased costs to the taxpayer. In addition, the Director did not provide evidence to support the estimate of 12 additional DCAA CORs needed to implement Recommendation 2. The PWS of each contract prohibits the DCAA COR from directing, supervising, or controlling the actions of the non-Federal auditors. As a result, the recommendation does not require that the DCAA COR serve as the quality management system for the non-Federal auditors or supervise the work of the non-Federal auditors. The DCAA CORs already review the non-Federal auditors' workpapers and reports and document their reviews. However, the reviews were not effective in helping to prevent GAS noncompliances because they did not use measurable criteria from Government Auditing Standards to conduct the reviews.
- The DCAA Director did not provide evidence to support their statement that the recommendation would have an adverse effect on small business non-Federal auditors. Recommendation 2 does not place an unnecessary burden on the non-Federal auditors because it would only require that the non-Federal auditors furnish the sample plan with the audit plan to the DCAA CORs to help identify the sample plan deficiencies before fieldwork completion.
- We recognize that the DCAA has established processes that apply before and after a contract award. However, we determined that the processes are not sufficient to reasonably ensure that the non-Federal auditors comply with Government Auditing Standards. As a result, the Government may be paying non-Federal auditors for audits that do not fulfill the contract requirements and do not adequately protect against the payment of significant unallowable costs.

Therefore, we request that the DCAA Director provide additional comments within 30 days of the final report to address whether the PWS provides DCAA CORs with the authority to review the non-Federal auditor work for compliance with Government Auditing Standards and provide a plan to update the PWS, if necessary. We also request additional comments on the Director's intent to modify the PWS to assist the DCAA CORs' review of the sample plan with the audit plan.

Defense Logistics Agency Comments

The DLA Director of Acquisition, responding for the DLA Director, disagreed and stated that the DLA is not responsible for the establishment of specific standards. The Director stated that the DLA will continue to work with the DCAA to confirm that documents provided to DoD contractors are sufficient to ensure contract performance.

Our Response

The DLA Director of Acquisition did not address the specifics of Recommendation 2; therefore, the recommendation is unresolved. Our recommendation does not request that the DLA Director establish specific standards. As the contracting office, the DLA is responsible for working with the DCAA to include contract requirements in contracts. Therefore, the DCAA should coordinate any PWS updates with the DLA Director, who is responsible for incorporating the updates in future contracts with the non-Federal auditors. Therefore, within 30 days of the final report, we request that the DLA Director provide additional comments addressing their plan to work with the DCAA to ensure that PWS updates incorporated in future contracts.

Recommendation 3

We recommend that the Defense Contract Audit Agency Director, in coordination with the Defense Logistics Agency Director, require non-Federal auditors to include in the quality control plan their planned procedures for complying with Government Auditing Standards, including:

- a. **Government Auditing Standards 1.18a, "Examination."**
- b. **Government Auditing Standards 7.13, "Results of Previous Engagements."**
- c. **Government Auditing Standards 7.14, "Investigations or Legal Proceedings."**
- d. **Government Auditing Standards 7.34, "Examination Engagement Documentation."**
- e. **Standards for Attestation Engagements Number 18, section §205A.31, "Sampling."**

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the DoD OIG did not review the non-Federal auditors' system of quality controls. The Director stated that the DoD OIG has not established a systemic, material deficiency to warrant Recommendation 3. The Director also stated that the non-Federal auditors'

quality control plans were not the cause of the noncompliances with Government Auditing Standards. Lastly, the Director stated that the recommendation would discourage participation in the non-Federal auditor program.

Our Response

The DCAA Director's comments did not address the specifics of Recommendation 3, therefore, the recommendation is unresolved. Although we did not review the non-Federal auditors' system of quality controls, we identified significant noncompliances with Government Auditing Standards. We disagree that the noncompliances we identified do not warrant implementing the recommendation. The evidence we gathered from 16 selected audits demonstrated systemic noncompliances associated with at least half of the non-Federal auditors that participated in the program from FY 2019 through FY 2022. For example, our evaluation established that the auditors for 50 percent of the audits (8 of 16) did not obtain sufficient evidence to support their reported conclusions.

During the evaluation, the DCAA CORs stated that they relied on the non-Federal auditors' quality control plans to reduce the risk of noncompliances with Government Auditing Standards. However, the results of our evaluation demonstrate that the DCAA CORs' reliance on the quality control plans did not reasonably ensure that the non-Federal auditors' work complied with Government Auditing Standards. Further, the DCAA CORs did not have a reasonable basis to rely on the quality control plans because the plans did not address how the non-Federal auditors would comply with Government Auditing Standards.

The Director did not provide evidence supporting that the recommendation would discourage participation in the non-Federal auditor program. Section 4.5.3 of the contract with the non-Federal auditors already requires that the auditors prepare a quality control plan that includes a plan to comply with Government Auditing Standards. The recommendation should help to ensure that the non-Federal auditors comply with the Section 4.5.3 requirement. We request that the DCAA Director provide additional comments within 30 days of the final report to provide a plan to address the recommendation or to provide alternative corrective actions.

Defense Logistics Agency Comments

The DLA Director of Acquisition, responding for the DLA Director, disagreed and stated that the DLA is not responsible for the establishment of specific standards. The Director stated that the DLA will continue to work with the DCAA to confirm that documents provided to non-Federal auditors are sufficient to ensure contract performance.

Our Response

The DLA Director of Acquisition did not address the specifics of Recommendation 3; therefore, the recommendation is unresolved. Recommendation 3 does not request that the DLA establish specific standards. However, the DLA plays a key role in incorporating updates to standards that the DCAA establishes into the contracts with the non-Federal auditors. Recommendation 3 addresses the need for the DCAA to coordinate closely with the DLA Director to ensure that the quality control plans cover compliance with Government Auditing Standards. Therefore, we request that the DLA Director provide comments within 30 days of the final report.

Recommendation 4

We recommend that the Defense Contract Audit Agency Director modify their quality assurance surveillance plan checklist to include a review of workpapers for compliance with Government Auditing Standards, including:

- a. **Government Auditing Standards 1.18a, “Examination.”**
- b. **Government Auditing Standards 7.13, “Results of Previous Engagements.”**
- c. **Government Auditing Standards 7.14, “Investigations or Proceedings.”**
- d. **Government Auditing Standards 7.34, “Examination Engagement Documentation.”**
- e. **Standards for Attestation Engagements Number 18, section §205A.31, “Sampling.”**

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the DoD OIG did not identify systemic and material deficiencies with the use of non-Federal auditors. The Director also stated that Recommendation 4 would increase costs to the taxpayers and adversely affect small business non-Federal auditors.

Our Response

The DCAA Director’s comments did not address the specifics of Recommendation 4, therefore, the recommendation is unresolved. We identified significant noncompliances with Government Auditing Standards that increased the risk of non-Federal auditors not identifying and questioning unallowable costs charged to DoD contracts. The comments do not include sufficient evidence to support the Director’s statement that Recommendation 4 would result in increased costs to the taxpayer.

Recommendation 4 will help to ensure that the DoD receives a quality audit, which complies with the key contractual requirement for adhering to Government Auditing Standards. Specifically, the recommendation consists of modest improvements to the DCAA checklists so that the DCAA CORs use significant criteria from Government Auditing Standards before they approve the audit workpapers. We request that the DCAA Director provide additional comments within 30 days of the final report to provide a plan to address the recommendation or propose alternate actions to help ensure that the DCAA CORs review non-Federal auditor workpapers for compliance with Government Auditing Standards.

Appendix A

Scope and Methodology

We evaluated the extent to which non-Federal auditors complied with Government Auditing Standards and other professional standards when they performed audits of DoD contractor incurred costs. Our evaluation covered incurred cost audits that non-Federal auditors completed from October 1, 2018, through September 30, 2022. We selected and evaluated a reasonable cross-section of incurred cost audits that the non-Federal auditors completed during this 3-year period.

We did not review the non-Federal auditors' systems of quality control, which is the objective of an external peer review. A system of quality control encompasses the organizational structure, the policies adopted, and procedures established to provide the non-Federal auditors with reasonable assurance of conforming in all material respects with Government Auditing Standards and applicable legal and regulatory requirements. The elements of quality control are described in Government Auditing Standards. Instead, we tested a nonstatistical sample of non-Federal incurred cost audits for compliance with Government Auditing Standards and other professional standards to the extent we considered appropriate.

We conducted this evaluation from October 2022 through August 2024 in accordance with the "Quality Standards for Inspection and Evaluation," published in December 2020 by the Council of Inspectors General on Integrity and Efficiency. Those standards require that we adequately plan the evaluation to ensure that objectives are met and that we perform the evaluation to obtain sufficient, competent, and relevant evidence to support the findings, conclusions, and recommendations. We believe that the evidence we obtained was sufficient, competent, and relevant to lead a reasonable person to sustain the findings, conclusions, and recommendations.

To accomplish our evaluation objective, we:

- reviewed applicable FAR and DFARS requirements related to DoD contractor incurred cost proposals;
- reviewed applicable Government Auditing Standards and other professional auditing standards related to examination engagements;
- selected a nonstatistical sample of 16 incurred cost audits that the non-Federal auditors completed;
- interviewed DCAA personnel and non-Federal auditors to clarify the procedures they performed;

- evaluated incurred cost audit workpapers prepared by the non-Federal auditors to determine if they complied with the Government Auditing Standards and other professional standards; and
- evaluated the monitoring activities the DCAA CORs performed to help ensure that non-Federal auditors completed the incurred cost audits in accordance with Government Auditing Standards.

We Selected a Nonstatistical Sample of 16 Incurred Cost Audits

To accomplish our objective, we selected a nonstatistical sample of 16 incurred cost audits from a universe of 369 audits that non-Federal auditors completed from October 1, 2018, through September 30, 2022. The 16 audits comprise a reasonable cross-section of the 369 audits that the non-Federal auditors completed during this period. In choosing the nonstatistical sample of 16 audits, we selected:

- at least one audit from each of the nine non-Federal audit firms that completed the 369 incurred cost audits; and
- audits that resulted in higher costs examined and lower costs questioned by the non-Federal auditors.

See Appendix B for a list of the 16 selected incurred cost audits.

Criteria

We reviewed criteria from Federal laws and regulations, auditing standards, and DoD and Government Accountability Office manuals. The following criteria were most pertinent to our evaluation and conclusions in this report.

Laws and Regulations

- FAR Part 31, “Contract Cost Principles and Procedures,” Subpart 31.2 “Contracts with Commercial Organizations”
- FAR Part 42, “Contract Administration and Audit Services,” Subpart 42.7 “Indirect Cost Rates”
- FAR Part 52, “Solicitation Provisions and Contract Clauses”
- Defense Federal Acquisition Regulation Supplement (DFARS) Part 231, “Contract Cost Principles and Procedures,” Subpart 231.2 “Contracts With Commercial Organizations”
- DFARS Part 237 “Service Contracting,” Subpart 237.2 “Advisory and Assistance Services,” Subpart 237.270 “Acquisition of audit services”
- DFARS Part 242, “Contract Administration,” Subpart 242.7 “Indirect Cost Rates”

- DFARS Part 252, “Solicitation Provisions for Contract Clauses”
- DFARS Part 252, “Solicitation Provisions and Contract Clauses,” Subpart 252.2, “Text of Provisions and Clauses,” Section 252.237-7000 “Notice of Special Standards of Responsibility”
- DFARS Part 252, “Solicitation Provisions and Contract Clauses,” Subpart 252.2, “Text of Provisions and Clauses,” Section 252.237-7001 “Compliance with audit Standards”
- Cost Accounting Standards Part 9903, “Contract Coverage”
- Cost Accounting Standards Part 9904, “Cost Accounting Standards”

Auditing Standards

- Government Auditing Standards, Revision 2011
- Government Auditing Standards, Revision 2018
- American Institute of Certified Public Accountants’ Statements on Standards for Attestation Engagements Number 18

DoD and GAO Manuals

- DoD Manual 7600.07, “DoD Audit Manual,” dated August 3, 2015
- Government Accountability Office, “Financial Audit Manual,” dated June 2022

Use of Computer-Processed Data

We used computer-processed data from the DCAA, which listed incurred cost audits that non-Federal auditors completed from FY 2018 through FY 2022. We verified that the DCAA prepared the list using data residing in the DCAA Management Information System. We further tested the validity of the list by tracing details of the selected reports to source documents, including DLA contract documents. We determined that the computer-processed data were sufficiently reliable.

Use of Technical Assistance

We did not obtain technical assistance.

Prior Coverage

We have not evaluated any non-Federal audits of DoD contractor incurred cost audits during the last five years.

Appendix B

Table 2 lists the 16 non-Federal incurred cost audits that we selected for our evaluation, including the contract number with the non-Federal auditor, the audit report number established for the non-Federal audit, and the costs that the non-Federal auditor examined and questioned.

Table 2. Non-Federal Incurred Cost Audits that We Selected for Our Evaluation

Count	DLA Contract Number (Ending in)	Audit Report Number (Ending in)	Costs Examined (in Thousands)	Costs Questioned (in Thousands)
1	20-F-0061	2019J10100001	\$1,940,586	\$0
2	19-F-0084	2018A10100008	101,982	0
3	21-F-0025	2020J10100007	3,020,000	0
4	22-F-0010	2020S10100003	293,841	58
5	20-F-0124	2019P10100003	214,769	0
6	20-F-0097	2019R10100001	151,918	0
7	22-F-0006	2020R10100011	433,957	0
8	22-F-0006	2020A10100005	187,740	0
9	22-F-0003	2020P10100003	235,791	0
10	21-F-0032	2019Q10100002	62,116	0
11	21-F-0080	2020J10100004	651,874	0
12	19-F-0035	2018K10100002	572,057	0
13	21-F-0073	2020P10100030	551,910	0
14	22-F-0002	2020M10100002	6,375	154
15	19-F-0031	2018K10100732	58,021	0
16	22-F-0002	2020K10100432	114,615	252
Total			\$8,597,552	\$464

Source: The DoD OIG, based on data received from the DCAA.

Appendix C

Table 3 lists the 11 audits where we identified instances of noncompliance with Government Auditing Standards.

Table 3. Non-Federal Incurred Cost Audits that Did Not Fully Comply with Government Auditing Standards

Count	DLA Contract Number (Ending in)	Audit Report Number (Ending in)	Noncompliances			
			Insufficient Evidence	Insufficient Sample	Inadequate Documentation	Lack of Management Inquiries
1	20-F-0061	2019J10100001	X	X	X	X
2	19-F-0084	2018A10100008	X	X	X	X
3	21-F-0025	2020J10100007			X	X
4	22-F-0010	2020S10100003	X		X	X
5	20-F-0124	2019P10100003	X		X	X
6	20-F-0097	2019R10100001	X	X	X	X
7	22-F-0006	2020R10100011			X	X
8	22-F-0006	2020A10100005			X	X
9	22-F-0002	2020M10100002	X		X	X
10	22-F-0002	2020K10100432	X		X	X
11	19-F-0031	2018K10100732	X	X	X	X
Number of Instances			8	4	11	11

Source: The DoD OIG, based on data received from the DCAA.

Appendix D

Management Comments on the Finding and Our Response

The DCAA Director provided management comments on the eight noncompliance examples from the 11 audits that we addressed in the Finding section. The Director's full comments are included in the Management Comments section. The following section provides a summary of our findings, the Director's comments, and our response.

The Non-Federal Auditors Did Not Obtain Sufficient Evidence for 8 of 16 Audits

For 8 of 16 audits, the non-Federal auditors did not obtain sufficient evidence to fully support their conclusions in the incurred cost audit reports in accordance with Government Auditing Standard (GAS) 1.18a, "Examination."

Defense Contract Audit Agency Comments

The DCAA Director disagreed with all eight instances where the DoD OIG determined that the non-Federal auditors did not obtain sufficient evidence in noncompliance with GAS 1.18a. For three of the eight audits, the Director stated that the non-Federal auditors could have improved their documentation. However, the Director stated that the three instances met the requirement for sufficient evidence. The Director also provided comments in response to the two examples discussed in the report.

For audit report number ending in 2020M1010002, the Director stated the non-Federal auditors documented in the workpapers that the equipment rental costs complied with the FAR and the contract. In addition, the Director stated that the non-Federal auditor reviewed the contract to understand contract requirements.

For audit report number ending in 2020S10100003, the Director stated that the non-Federal auditor obtained copies of the DoD contractor's compensation policies which provided an adequate basis for understanding compensation. The Director also stated that the compensation policy was based on salary surveys. Finally, the Director stated that the risk of unreasonable compensation does not exist based on previous audit history.

Our Response

The DCAA Director's comments did not provide sufficient evidence to change our determination that the auditors did not obtain support for their conclusions.

For audit report number ending in 2020M1010002, we recognize that the non-Federal auditor stated in the workpapers that the equipment rental costs complied with the FAR and contract terms. However, the non-Federal auditor did not explain how they determined that the costs complied with the FAR and contract terms. We also recognize that the non-Federal auditor reviewed the contract requirements. For example, the summary of contract requirements included provisions for subcontracts, fees, and travel costs. Although the non-Federal auditor reviewed the contract requirements, the auditor's summary of the contract requirements was not sufficient to establish that the equipment rental costs were needed for, and allocable to, the contract.

For the audit report number ending in 2020S10100003, we recognize that the non-Federal auditor gained an understanding of the DoD contractor's compensation policy. We are also aware that the non-Federal auditor documented in the workpapers that previous audits did not identify any unallowable direct labor costs. However, obtaining an understanding of the compensation policy and documenting the results of previous audits alone was not sufficient to establish the reasonableness of direct labor costs. The non-Federal auditor must also determine that the compensation policy was adequate, and that the DoD contractor followed the policy. The non-Federal auditor could have limited testing if they determined that the previous year's audit tested direct labor for reasonableness with no exceptions and the DoD contractor made no changes to direct labor. However, the workpapers did not provide evidence that the non-Federal auditor determined that an auditor had tested direct labor for reasonableness in the previous year's audit. Additionally, the non-Federal auditor's workpapers noted that direct labor costs increased 10 percent from the previous year. However, the non-Federal auditor did not state how they determined the 10 percent increase in direct labor costs was reasonable under the circumstances. Finally, the non-Federal auditor's procedures were limited to verifying that the timesheets were signed and approved, the mathematical calculations were accurate, and the costs were properly recorded in the accounting system. These procedures were not sufficient to determine if the direct labor costs were reasonable.

The Non-Federal Auditors Did Not Use a Sufficient Sample Methodology for 4 of 16 Audits

For 4 of 16 audits, the non-Federal auditors did not use a sufficient sample methodology to support their conclusions in the incurred cost audit reports, as required by Statements on Standards for Attestation Engagements number 18 (AT-C) §205A.31, "Sampling."

Defense Contract Audit Agency Comments

The DCAA Director agreed that two of four audits did not use a sufficient sample methodology in accordance with AT-C §205A.31. For the remaining two audits, the Director disagreed that the sample methodology was insufficient. Specifically, for audit report number ending in 2018K10100732, the Director stated that the non-Federal auditor documented their justification for selecting 59 transactions. The Director also stated that the non-Federal auditor did not expand their sample because they determined that the noncompliances with payment documentation were immaterial.

For audit report number ending in 2019R10100001, the Director stated the non-Federal auditor documented that they selected from “sub-samples” because the trial balance did not provide details at the transaction level.

Our Response

The DCAA Director did not provide sufficient evidence to support the sufficiency of the sample methodology. For audit report number ending in 2018K10100732, we recognize that the non-Federal auditor documented that they did not expand their sample or report the questioned costs because the amounts were immaterial. However, the non-Federal auditor did not explain how their sample size was sufficient. According to the workpapers, the non-Federal auditor based the sample size on the expectation that they would not identify any noncompliances. The non-Federal auditor’s sample methodology required a sample size greater than 59 if the auditor found any noncompliances. However, the non-Federal auditor did not follow their sample methodology that they would not identify any noncompliances. Although the non-Federal auditor identified three noncompliances (a 5 percent noncompliance rate), they did not increase the sample size. We understand that the dollar values of the three noncompliances may be immaterial. However, if the auditor expanded testing due to the 5 percent rate of noncompliances, the questioned costs could have become significant.

For audit report number ending in 2019R10100001, we understand that the non-Federal auditor selected “sub-samples” due to trial balance limitations. However, the workpapers do not include evidence that the non-Federal auditor requested, or the DoD contractor could not provide, individual transactions by account. If the trial balance limitations prevented the non-Federal auditor from examining a significant amount of proposed costs, they should have considered reporting a limitation to the audit scope.

The Non-Federal Auditors Did Not Sufficiently Document the Work They Performed for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not sufficiently document the work they performed in accordance with GAS 7.34, “Examination Engagement Documentation.”

Defense Contract Audit Agency Comments

The DCAA Director agreed that 2 of 11 audits were not sufficiently documented. However, the Director did not agree with the two reported examples. For audit report number ending in 2020J101000007, the Director stated that the non-Federal auditor used an industry standard when documenting the materiality calculation. Also, the Director acknowledged that the non-Federal auditor could have improved their documentation of the calculation. The Director stated that an experienced auditor should have known the non-Federal auditors used an industry standard template. The Director also stated that the DoD OIG should have obtained an understanding of the internal controls, policies, and procedures for the non-Federal auditor. Finally, the Director stated that the DoD OIG did not question this practice when used in the other selected audits.

For audit report number ending in 2018A101000008, the Director stated that our finding was not accurate because the non-Federal auditor documented a meeting with DCAA where the previous audit history was discussed. In addition, the Director stated that the non-Federal auditor documented their consideration of risk associated with the previous audit history.

Our Response

The DCAA Director’s comments did not address the insufficient documentation of the non-Federal auditors’ rationale in the two reported examples. For audit report number ending in 2020J101000007, we recognize that the non-Federal auditor used an industry standard when establishing materiality. However, the non-Federal auditor did not apply the standard correctly. Typically, the auditor establishes the materiality for the audit, which they use for selecting accounts to test. The non-Federal auditor established a materiality minimum of \$14 million for the audit. In addition, the non-Federal auditor calculated a materiality minimum for each cost element regardless of the cost element’s materiality to the audit. For example, the non-Federal auditor calculated a materiality minimum for the travel cost element. The non-Federal auditor tested the \$358,100 travel costs element, which was significantly less than the materiality minimum for the audit. In addition, the non-Federal auditor did not account for the risk to the Government when calculating the materiality for indirect costs. For example, the non-Federal

auditor calculated a materiality minimum of \$9.9 million for the labor fringe costs. However, only \$3.3 million of the labor fringe costs were charged to DoD contracts and within the scope of the audit. As a result, the non-Federal auditor tested \$6.6 million in labor fringe costs that were outside the scope of the audit. To understand the non-Federal auditor materiality calculation, we had to make additional inquiries to understand the non-Federal auditor's rationale because they did not document it in the workpapers.

We disagree that the DoD OIG should have obtained an understanding of the internal controls, policies, and procedures of the non-Federal auditors. GAS 7.36 describes an experienced auditor as someone who has the competencies and skills to perform the audit. Government Auditing Standards do not require that an experienced auditor understand the policies and procedures of the non-Federal auditor to have the necessary competencies and skills. An experienced auditor should be able understand the procedures the non-Federal auditor performed, the evidence they obtained, and the conclusions they reached without having to obtain an understanding of the non-Federal auditor's internal controls, policies, and procedures. Additionally, the Director's statement that the DoD OIG did not question this practice in other non-Federal auditor assignments we selected is incorrect. We identified four audits when non-Federal auditors did not adequately document their materiality calculations.

For audit report number ending in 2018A10100008, we recognize that the non-Federal auditor documented the previous audit findings. However, the non-Federal auditor did not document the effect that the previous audit findings had on the overall risk for the audit.

The Non-Federal Auditors Did Not Make Inquiries with the DoD Contractor's Management for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not make required inquiries with the DoD contractor's management in accordance with GAS 7.13, "Results of Previous Engagements," or GAS 7.14, "Investigations or Legal Proceedings."

Defense Contract Audit Agency Comments

The DCAA Director disagreed with all 14 noncompliances identified in 11 of 16 audits where the DoD OIG determined that the non-Federal auditors did not comply with GAS 7.13 and 7.14. For audit report number ending in 2019R10100001, the Director stated that the management representation letter contained a statement from the DoD contractor that they were not aware of any noncompliance or suspected noncompliance with laws, regulations, and contract provisions affecting the audit. The Director stated that although the non-Federal auditor issued the management

representation letter at the end of the audit, it does not mean that the management inquiry did not occur earlier during the audit. The Director also stated that this is standard practice for private sector auditors.

For audit report number ending in 2018K10100732, the Director stated the DoD OIG report does not accurately represent the workpapers. The Director stated the non-Federal auditor inquired about the previous incurred cost audit findings and designed tests to determine if the previous-year audit finding continued to exist.

Our Response

The DCAA Director's comments did not address the specifics of the findings for the two reported examples. For audit report number ending in 2019R10100001, the management representation letter did not address the GAS 7.14 requirement that the auditor inquire with the DoD contractor about any investigations or legal proceedings that may affect the audit. The Director did not provide evidence that an inquiry occurred earlier during the audit. Additionally, the non-Federal auditor did not document in the workpapers, including the management representation letter, that any inquiries related to investigations or legal proceedings occurred at any time during the audit. To avoid interfering in an investigation or legal proceeding, the non-Federal auditor should have inquired during audit planning. The management representation letter was required in accordance with AT-C 205A.50, which Government Auditing Standards incorporates by reference. However, the management representation letter was not sufficient to comply with GAS 7.14.

For audit report number ending in 2018K10100732, we recognize that the non-Federal auditor inquired about previous audit findings. However, we identified a noncompliance with GAS 7.13 because the non-Federal auditor did not ask DoD contractor management if they had taken corrective actions on the previous findings. The DCAA questioned \$2.7 million of labor costs in a previous audit because the employees did not meet the contractual labor qualifications. We recognize that the non-Federal auditor tested labor qualifications. However, the non-Federal auditor did not design their tests to determine if the specific employees identified in the previous audit finding continued to be proposed in the incorrect labor category. When we asked the non-Federal auditor why they did not consider the specific employees from the previous audit finding, they stated that the DCAA did not inform them of the affected employees. However, a list of affected employees was included in the previous audit report, which was included in the audit documentation. The non-Federal auditor could have used the list to determine if the specific employees were again proposed in the incorrect labor category.

Appendix E

Supplementary Management Comments on the 11 Audits with Noncompliances and Our Response

The DCAA Director provided supplementary comments on each of the 34 instances of noncompliances among the 11 audits. The supplementary management comments are in addition to those summarized in Appendix D of this report. The following section provides a summary of our findings, the DCAA Director's supplementary comments, and our responses by audit report number.

1. Audit Report Number Ending in 2019J10100001

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$30.9 million incurred costs in accordance with Government Auditing Standard (GAS) 1.18a, "Examination." For example, the workpapers did not provide sufficient evidence to determine if \$1 million in subcontract costs were allowable, allocable, and reasonable. During audit planning, the non-Federal auditor identified a subcontract where they needed assistance from DCAA to audit. The non-Federal auditor did not test the subcontract or document why they did not test the subcontract.

Defense Contract Audit Agency Comments

The DCAA Director partially agreed with the finding. The Director agreed that the non-Federal auditor did not test the subcontract identified in our noncompliance. However, the Director stated that the subcontract would only have added approximately \$1 million to the universe. In addition, the non-Federal auditor tested the account and did not identify unallowable costs. Lastly, the Director stated that the subcontract was selected for DCAA audit assistance based on the significance of the subcontract dollars and no other risk factors were noted.

Our Response

According to the planned procedures, the non-Federal auditor would perform procedures on all significant subcontract costs regardless of requesting an assist audit, such as determining whether the subcontract audit assistance was needed and costs were paid. In addition, the non-Federal auditor planned to perform procedures on subcontracts where an assist audit was not requested, such as validating billing rates. For the subcontract where the non-Federal auditor could not receive DCAA audit assistance, the non-Federal auditors did not perform any

testing or explain that no testing was necessary. In addition, the non-Federal auditor did not perform any testing of subcontracts where an assist audit was requested. Therefore, the non-Federal auditor's testing did not adequately address the risk identified during planning.

DoD OIG Finding

The non-Federal auditors did not use a sufficient sample methodology to support their conclusions in the incurred cost audit reports, as required by Statements on Standards for Attestation Engagements number 18 (AT-C) §205A.31. The non-Federal auditor developed a universe that did not match with the DoD contractor's incurred cost proposal. For example, the non-Federal auditor selected a sample from a universe of labor costs that totaled \$4.1 million, even though the labor costs in the DoD contractor's incurred cost proposal totaled \$3.3 million. The non-Federal auditor was not able to explain the difference.

Defense Contract Audit Agency Comments

The DCAA Director agreed with the finding.

DoD OIG Finding

The non-Federal auditor did not document the testing of subcontract costs in sufficient detail to determine whether the costs were allowable, allocable, and reasonable in accordance with GAS 7.34, "Examination Engagement Documentation."

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented the procedures they performed and evidence they obtained.

Our Response

In the workpaper, the non-Federal auditor did not document how they determined that the costs complied with the testing criteria. For example, the non-Federal auditor stated that they tested for reasonableness, but the non-Federal auditors did not explain the procedures they performed to determine reasonableness.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any applicable previous audit findings or corrective actions on previous audit findings in accordance with GAS 7.13, "Results of Previous Engagements."

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor used the previous audit findings and corrective action plan from the previous year's audit. The Director also stated that the non-Federal auditor inquired about internal and external audits in the current audit and that it can be assumed that if new items existed, the non-Federal auditor had added them to the request.

Our Response

We recognize that the non-Federal auditor documented the previous audit finding and referenced the corrective action plan in the workpapers based on the inquiry performed in the previous year's audit. In addition, we noted that the non-Federal auditor inquired with the DCAA on previous audit findings. However, the non-Federal auditor did not inquire with DoD contractor management on previous audit findings as GAS 7.13 requires.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14, "Investigations or Legal Proceedings."

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor presented this question about investigations or legal proceedings to the contractor, which was included in a the workpaper.

Our Response

Although we communicated to the DCAA that we no longer consider this to be a noncompliance with GAS 7.14, the DCAA Director provided comments. Additionally, we previously removed this noncompliance from an earlier draft of this report. We recognize that the non-Federal auditor performed the inquiry but did not document the results.

2. Audit Report Number Ending in 2018A10100008

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$129.5 million in incurred costs in accordance with GAS 1.18a. For example, the workpapers did not include sufficient evidence to determine if \$47.4 million in subcontract costs were allowable, allocable, and reasonable.

Defense Contract Audit Agency Comments

The DCAA Director stated that the finding is more of a documentation issue and not an evidence issue. The Director stated that the non-Federal auditor documented that they reviewed subcontract agreements and obtained “supporting documents.”

Our Response

Obtaining subcontract agreements and supporting documents was not sufficient to support the reported conclusion. The non-Federal auditor was required to obtain evidence and perform procedures to determine the subcontract costs were paid, needed for the contract, and obtained at reasonable amounts. However, the non-Federal auditor did not identify what specific evidence they obtained and procedures they performed to determine that the subcontract costs were allowable, allocable, and reasonable. Additionally, we determined that the non-Federal auditor only selected subcontract costs from the contracts that were ready to be closed. The non-Federal auditor did not select costs from ongoing contracts. As a result, the non-Federal auditors excluded a significant portion of subcontract costs relevant to the audit.

DoD OIG Finding

The non-Federal auditors did not use a sufficient sample methodology to support their conclusions as required by AT-C §205A.31. The non-Federal auditor developed a universe of costs that was not appropriate and sufficient. The non-Federal auditor established a materiality minimum of \$721,857. However, the auditor selected costs less than the minimum and did not select costs that exceeded the minimum. The non-Federal auditor did not document their rationale for the selection.

Defense Contract Audit Agency Comments

The DCAA Director agreed with the finding.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor’s management about any applicable previous audit findings or corrective actions related to previous audit findings in accordance with GAS 7.13.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented the previous incurred cost audit findings and included them as a discussion topic for a meeting with the DoD contractor.

Our Response

We agree that the auditor documented their plan to perform the inquiry during a meeting with DoD contractor management. However, the auditor did not document whether they performed the inquiry or received a response.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14 of the 2018 Government Auditing Standards and GAS 5.10 of the 2011 Government Auditing Standards.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the management representation letter addressed the requirement. The Director explained that the letter is the final required audit document from the DoD contractor but that the non-Federal auditor would have discussed the letter before the report date. The Director stated that GAS 7.14 does not state when the inquiry must occur. Additionally, the Director stated that GAS 5.10 of the 2011 Government Auditing Standards would have been applicable instead of GAS 7.14 of the 2018 Government Auditing Standards.

Our Response

The sections of the management representation letter referenced by the DCAA Director are related to fraud and non-compliances in financial reporting practices. Therefore, the management representation letter is not evidence of an inquiry on investigative or legal proceedings. We recognize that GAS 5.10 was applicable to the selected audit. GAS 5.10 states:

When investigations or legal proceedings are initiated or in process, auditors should evaluate the impact on the current examination engagement. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, or withdraw from or defer further work on the examination engagement or a portion of the examination engagement to avoid interfering with an ongoing investigation or legal proceeding.

To evaluate the effect of an investigation or legal proceedings on an audit, the non-Federal auditor needed to first attempt to identify any investigations or legal proceedings that have been initiated or are in process. Therefore, the non-Federal auditor did not comply with GAS 5.10 because they could not evaluate the effect of investigations or legal proceedings on an audit without first attempting to identify the existence of any investigations or legal proceedings. We recognize GAS 5.10 does not require a specific time to perform the inquiry. However, because the management representation letter date and audit report were issued on the same day, the non-Federal auditor did not have sufficient time to evaluate the effect on the current audit and withdraw from or defer further work on the audit to avoid interfering with investigations or legal proceedings.

3. Audit Report Number Ending in 2020J10100007

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the management representation letter addressed this requirement. Additionally, the Director stated that the timing of the inquiry is not stated in GAS 7.14.

Our Response

The sections of the management representation letter referenced by the DCAA Director relate to fraud and non-compliances in financial reporting practices. Therefore, management representation letter did not provide sufficient evidence of an inquiry on investigative or legal proceedings. We recognize GAS 7.14 does not require a specific time to perform the inquiry. However, the management representation letter date is the same date as the audit report. The timing of the management representation letter did not provide the non-Federal auditor with sufficient time to evaluate the effect on the current audit and withdraw from or defer further work on the audit to avoid interfering with an investigations or legal proceedings.

4. Audit Report Number Ending in 2020S10100003

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$293.8 million in incurred costs in accordance with GAS 1.18a. For example, the workpapers did not include sufficient evidence to determine if \$141.1 million in non-labor costs were allowable, allocable, and reasonable.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the purpose of the workpaper was to test controls on payment. The Director stated that the non-Federal auditor explained the procedures performed to reach their conclusions. Additionally, the Director stated that the workpaper specifically listed the reference number for the supporting document for each transaction. The Director noted that the non-Federal auditor tested 360 transactions overall. Finally, the Director concluded that the General Auditing Standards do not require auditors to explain how they completed each test.

Our Response

Performing tests of payment controls is not sufficient to determine that costs are allowable, allocable, and reasonable. In addition, the non-Federal auditors workpapers did not list the reference number for the supporting documents of each transaction. For example, we identified missing reference numbers for supporting documents of 12 travel transactions. Also, for the reference numbers listed, the non-Federal auditor did not document what items they requested or received. We recognize that the non-Federal auditor tested 360 transactions. However, the sufficiency of evidence is not based solely on the quantity of transactions tested. In addition to determining the DoD contractor incurred and paid costs, the non-Federal auditor should have determined if the costs were needed for the contract and obtained at reasonable quantities and prices. Government Auditing Standards require auditors to document the nature, timing, and extent of procedures they performed and evidence they obtained.

DoD OIG Finding

The non-Federal auditor did not document in sufficient detail how they determined that job descriptions and external salary surveys were not needed to review executive compensation for reasonableness in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor obtained the DoD contractor's executive compensation policy and documented their results. The Director stated that it is unclear that the additional information mentioned in the finding was needed based on risk or would have changed the audit results.

Our Response

The non-Federal auditor did not sufficiently document how they determined the job descriptions and salary surveys were not needed to review executive compensation. The non-Federal auditor's audit plan stated that the procedure to obtain job descriptions and salary surveys did not apply because the information was not provided. Therefore, the non-Federal auditor's workpaper suggested that the information was needed but not provided.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor discussed compliance with laws and regulations during a fraud discussion with the DoD contractor. The Director also stated that it is reasonable to deduce that any lawsuits relevant to the subject matter would have been discussed during the fraud discussions.

Our Response

The non-Federal auditor's workpaper did not document an inquiry on investigations and legal proceedings. A discussion about compliance with laws and regulations concerning fraud does not provide sufficient evidence that the non-Federal auditor specifically inquired about investigations and legal proceedings in accordance with GAS 7.14.

5. Audit Report Number Ending in 2019P10100003

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$214.8 million incurred costs in accordance with GAS 1.18a. For example, the workpapers did not include sufficient evidence to determine if \$99.5 million in subcontract costs were allowable, allocable, and reasonable.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor explained the evidence they obtained and procedures they performed to test subcontract costs. The Director also stated that the non-Federal auditor explained why the sample size was appropriate considering the risk factors. Additionally, the Director stated that non-Federal auditor documented the workpaper in compliance with GAS 7.34.

Our Response

The DCAA Director's comments did not explain how the evidence that the non-Federal auditor obtained and procedures they performed were sufficient to determine if subcontract costs were allowable, allocable, and reasonable. The non-Federal auditor should have verified that the subcontract costs were paid, needed for the contract, and procured at reasonable quantities and prices. Government Auditing Standards require auditors to document the nature, timing, and extent of procedures they perform and evidence they obtain.

DoD OIG Finding

The non-Federal auditor did not adequately document if or how they planned to test controls in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that GAS 7.34 does not require testing of internal controls. The Director stated that the non-Federal auditor determined the risk was assessed as moderate or high. Also, the non-Federal auditor did not state that they were relying on the internal controls.

Our Response

We recognize that GAS 7.34 does not require the testing of internal controls. However, GAS 7.34 requires that an auditor prepare the engagement documentation in sufficient detail to enable an experienced auditor with no previous connection to the engagement to understand the work performed. The non-Federal auditor determined the control risk to be moderate or high; however, they did not document their planned procedures to address the risk.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14 of the 2018 Government Auditing Standards and GAS 5.10 of the 2011 Government Auditing Standards.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor inquired with the DoD contractor's management about investigations or legal proceedings during an interview.

Our Response

The non-Federal auditor's workpaper did not document an inquiry on investigations or legal proceedings. We are aware that the non-Federal auditor inquired with the DoD contractor's management about fraud and if the DoD contractor complied with laws and regulations related to the specific contract being audited. However, the interview notes did not provide any evidence that the non-Federal auditor specifically inquired about investigations and legal proceedings.

6. Audit Report Number Ending in 2019R10100001

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$151.8 million in incurred costs in accordance with GAS 1.18a. For example, the non-Federal auditor workpapers did not include sufficient evidence to conclude that \$43.8 million in labor costs were allowable, allocable, and reasonable. Additionally, the non-Federal auditor identified a \$20,000 difference in one transaction due to a bonus. However, the non-Federal auditor did not document any analysis of the bonus.

Defense Contract Audit Agency Comments

The DCAA Director partially agreed with the finding. The Director agreed that the non-Federal auditor did not thoroughly explain what supporting documentation they obtained. However, the Director concluded that the finding was more of a documentation issue and not an evidence issue. Additionally, the non-Federal auditor explained that because they had not taken exception to the bonus, the non-Federal auditor did not retain any evidence in the workpapers. Finally, the Director stated that the auditor obtained adequate support and performed appropriate tests.

Our Response

The non-Federal auditor should have determined if the labor costs were paid, needed for the contract, and procured at reasonable quantities and prices. Government Auditing Standards require auditors to document the nature, timing, and extent of procedures performed. In addition, the non-Federal auditor did not explain how they determined the allowability of the \$20,000 bonus.

DoD OIG Finding

For fringe costs, the non-Federal auditor listed their testing criteria, such as “[e]xpenditure is supported” in the workpapers; however, they did not include any additional information to explain how they tested the characteristics for fringe costs in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented the characteristics they tested and noted no exceptions. The Director stated that the workpaper meets the GAS 7.34 requirements.

Our Response

We recognize that the non-Federal auditor documented the characteristics they tested. However, the non-Federal auditor did not document the procedures they performed to test the characteristics, as required by GAS 7.34.

DoD OIG Finding

The non-Federal auditor workpapers do not reflect that the auditor had inquired about the results of internal reviews and corrective actions related to those reviews in accordance with GAS 7.13 of the 2018 Government Auditing Standards and GAS 5.10 of the 2011 Government Auditing Standards.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented the inquiry in the audit plan and referenced meeting agenda.

Our Response

The audit plan and meeting agenda documented that the non-Federal auditor planned to make inquiries about the results of internal reviews and related corrective actions. However, the non-Federal auditor did not document that they made the inquiry or received a response to it. Additionally, the non-Federal auditor told us that they did not inquire about the results of internal audits completed by the DoD contractor or whether the contractor had taken corrective action.

7. Audit Report Number Ending in 2020R10100011

DoD OIG Finding

The non-Federal auditor did not explain their reasoning for how they selected samples of direct costs in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director agreed with the finding.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor asked the DoD contractor's management about any knowledge of fraud and violations of laws or regulations. The Director also stated that inquiries related to fraud and legal proceedings are not required to be in separate documents or occur at separate times.

Our Response

The DCAA Director did not provide evidence that the non-Federal auditor inquired with DoD contractor management on investigations and legal proceedings. Although the non-Federal auditor inquired about known or alleged violations of applicable laws and regulations, the workpapers do not indicate if they received a response from the contractor.

8. Audit Report Number Ending in 2020A10100005

DoD OIG Finding

The non-Federal auditor did not document the procedures they performed or evidence they examined to determine the labor costs, non-labor costs, and fringe costs were allowable, allocable, and reasonable in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor listed the criteria they tested and explained the evidence they obtained. The Director stated that the workpapers meet the GAS 7.34 requirements.

Our Response

The non-Federal auditor did not document the procedures they performed or evidence they obtained to determine if the costs complied with the documented criteria in accordance with GAS 7.34. GAS 7.34 requires that an auditor prepare the engagement documentation in sufficient detail to enable an experienced auditor with no previous connection to the engagement to understand the work performed.

We are unable to understand the procedures that the non-Federal auditors performed or the evidence they obtained to determine if the costs were allowable, allocable, and reasonable.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor asked the DoD contractor's management about any knowledge of fraud and violations of laws or regulations. The Director stated that inquiries related to fraud and legal proceedings were not required to be in separate documents or occur at separate times.

Our Response

The DCAA Director did not provide evidence that the non-Federal auditor inquired with DoD contractor management on investigations and legal proceedings. Although the non-Federal auditor inquired about known or alleged violations of applicable laws and regulations, the workpapers did not indicate that the auditor obtained a response.

9. Audit Report Number Ending in 2020M10100002

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$1.8 million in incurred costs in accordance with GAS 1.18a. For example, the workpapers did not include sufficient evidence to determine whether \$48,216 in travel costs were allowable, allocable, and reasonable. The non-Federal auditor did not identify any justifications for travel, travel expense reports, or approved per diem rates.²⁰

Defense Contract Audit Agency Comments

The DCAA Director partially agreed with the finding. The Director agreed that the non-Federal auditor did not thoroughly explain the source of the per diem rates but stated that only one source exists for the per diem rates. The Director stated that

²⁰ Per diem is a specific amount of money that an organization gives per day to cover the employee's living expenses when travelling for official business. General Services Administration provides per diem rates for locations in the continental US. Per Diem, Travel and Transportation Allowance Committee provides per diem rates for locations in the US outside the continental US, including Alaska, Hawaii and the US territories and possessions. The Department of State provide per diem rates for all foreign locations.

the finding is more of a documentation issue and not an evidence issue related to GAS 1.18a. The DCAA Director also stated that the non-Federal auditor tested that the costs were allocable and reasonable.

Our Response

The non-Federal auditor did not explain how they determined the travel costs were allowable. For example, the non-Federal auditor did not obtain evidence of the location of the travel, which was needed to determine the reasonableness of the per diem rates. Additionally, the non-Federal auditor did not obtain evidence that the employee's travel was necessary for and allocable to the DoD contract. The non-Federal auditor only obtained timesheets and earnings statements related to the travel costs.

DoD OIG Finding

The non-Federal auditor did not document the procedures they performed or evidence they obtained to determine if labor, travel, equipment rental, and subcontract costs were allowable, allocable, and reasonable in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor included a majority of the supporting documentation they received and used for testing and that the workpaper explained the tests they performed.

Our Response

The non-Federal auditor did not document the procedures they performed and evidence they obtained to determine whether the costs complied with the documented criteria as required by GAS 7.34.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the management representation letter addressed this requirement. The Director explained that the letter is the final required audit document from the DoD contractor and that the non-Federal auditor would have discussed the letter before the report date. The Director stated that GAS 7.14 does not state when the inquiry must occur.

Our Response

The DCAA Director referenced sections of the management representation letter related to communications from agencies that issue rules and regulations. Investigations and legal proceedings may involve agencies that enforce or apply rules and regulations but do not issue rules and regulations. Therefore, the management representation letter does not provide sufficient evidence that the non-Federal auditor inquired on investigative or legal proceedings. We recognize GAS 7.14 does not require a specific time to perform the inquiry. However, the timing of the inquiry should allow for the auditor to evaluate the effect on the current audit and withdraw from or defer further work on the audit to avoid interfering with an investigations or legal proceedings. In this case, the management representation letter and the audit report were issued on the same date. Therefore, the management representation letter did not provide sufficient evidence that the non-Federal auditor had an opportunity to evaluate the effect of any investigations or legal proceedings.

10. Audit Report Number Ending in 2018K10100732

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$58 million incurred costs in accordance with GAS 1.18a. For example, the workpapers did not provide sufficient evidence to determine that \$613,650 in consultant costs were allowable, allocable, and reasonable.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor tested for reasonableness and allocability. Additionally, the DCAA Director stated that the non-Federal auditor explained the evidence they reviewed and procedures they performed. The Director stated that General Auditing Standards do not require auditors to explain step-by-step how they completed each test.

Our Response

The non-Federal auditor's documented procedures did not explain how the auditors tested for reasonableness and allocability. The non-Federal auditor obtained invoices and bank records which were not sufficient to determine if the costs were allocable or reasonable. In addition, the non-Federal auditor should have determined the consultant costs were needed for the contract and incurred at reasonable quantities and prices. Also, the FAR requires specific evidence for consultant costs, such as invoices, agreements, and work products

to determine allowability. Finally, Government Auditing Standards require auditors to document the nature, timing, and extent of procedures they performed and evidence they obtained.

DoD OIG Finding

The non-Federal auditor determined the proposed labor costs complied with the contracts. However, the non-Federal auditor did not document any contract requirements, such as employee qualifications, to support the determination that the costs were allowable in accordance with GAS 7.34.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented the procedures they performed. Additionally, the Director stated the non-Federal auditor documented in the sample plan that they planned to request employee resumes to verify qualifications. The Director stated the sample plan demonstrates that the non-Federal auditor planned to compare resumes to contracts.

Our Response

We recognize that the non-Federal auditor documented their plan to obtain resumes. However, the non-Federal auditor did not document whether they obtained resumes as part of their testing. Additionally, the non-Federal auditor did not document if they determined whether employees met the labor qualifications specified in the contract. GAS 7.34 requires auditors to document the nature, timing, and extent of procedures performed and evidence obtained.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14 of the 2018 Government Auditing Standards and GAS 5.10 of the 2011 Government Auditing Standards.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the management representation letter addressed this requirement. The Director explained that the letter is the final required audit document from the contractor but that the non-Federal auditor would have discussed the letter before the report date. The Director also stated that GAS 7.14 does not state when the inquiry must occur.

Our Response

The DCAA Director referenced sections of the management representation letter that are related to fraud and non-compliances in financial reporting practices. Therefore, the management representation letter is not evidence of an inquiry on investigative or legal proceedings. We recognize GAS 7.14 does not require a specific time to perform the inquiry. However, the timing of the inquiry should allow for the auditor to evaluate the effect on the current audit and withdraw from or defer further work on the audit to avoid interfering with an investigations or legal proceedings. In this case, the management representation letter and the audit report were issued on the same date. Therefore, the management representation letter did not provide sufficient evidence that the non-Federal auditor had an opportunity to evaluate the effect of any investigations or legal proceedings.

11. Audit Report Number Ending in 2020K10100432

DoD OIG Finding

The non-Federal auditor did not obtain sufficient evidence to provide a conclusion on the allowability of \$59.1 million incurred costs in accordance with GAS 1.18a. For example, the non-Federal auditor workpapers did not include sufficient evidence to determine if \$38.4 million in material costs were allowable, allocable, and reasonable. In addition, the non-Federal auditor did not document how they examined the evidence they obtained.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the non-Federal auditor documented procedures they performed and evidence they obtained. The Director stated that the finding goes beyond the requirement of General Auditing Standards.

Our Response

We recognize that the non-Federal auditor stated that they confirmed material costs were allowable. However, the non-Federal auditor's documented procedures do not explain how they tested for allowability. The non-Federal auditor obtained invoices which were not sufficient to determine the costs are allowable, allocable, and reasonable. In addition to determining the DoD contractor incurred material costs, the non-Federal auditor should have determined the material costs were paid, needed for the contract, and purchased at reasonable quantities and prices. Government Auditing Standards require auditors to document the nature, timing, and extent of procedures they performed and evidence they obtained.

DoD OIG Finding

The non-Federal auditor did not document their consideration of applicable Cost Accounting Standards in any of the workpapers in accordance with GAS 7.34.²¹

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the contracting officer's price negotiation memorandum identified that the DoD contractor was not subject to Cost Accounting Standards because it was a small business.²² The Director stated that the non-Federal auditor did not design tests to determine compliance with Cost Accounting Standards because the non-Federal auditor understood the appropriate criteria for testing.

Our Response

We recognize that the price negotiation memorandum stated that the DoD contractor was not subject to Cost Accounting Standards. However, the price negotiation memorandum was issued after the audit report and was not included in the workpapers. Therefore, the price negotiation memorandum was not considered by the non-Federal auditor during audit fieldwork. The non-Federal auditor documented that the contract was subject to Cost Accounting Standards in the workpapers. Therefore, they should have explained why they did not design or perform tests for compliance with Cost Accounting Standards.

DoD OIG Finding

The non-Federal auditor did not inquire with the DoD contractor's management about any investigations or legal proceedings in accordance with GAS 7.14.

Defense Contract Audit Agency Comments

The DCAA Director disagreed and stated that the inquiry occurred during a meeting between a representative from the non-Federal auditor and DoD contractor. The Director stated the inquiry covered fraud and violation of contract provisions. The Director concluded that the finding was based on DoD OIG's preference.

²¹ Cost Accounting Standards consist of nineteen standards published by the Cost Accounting Standards Board designed to ensure uniformity and consistency in the measurement, assignment, and allocation of costs to contracts and subcontracts with the Government.

²² The price negotiation memorandum describes the principal elements of negotiating incurred costs and specifies the factors considered for each element, or supports the total amount negotiated in reasonable detail.

Our Response

The DCAA Director did not provide evidence that the non-Federal auditor inquired with the DoD contractor's management on investigations and legal proceedings. The discussion about compliance with contract provisions did not provide sufficient evidence that the non-Federal auditor had specifically inquired about investigations and legal proceedings in accordance with GAS 7.14.

Management Comments

Defense Contract Audit Agency



OFFICE OF DIRECTOR

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

September 13, 2024

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR EVALUATIONS, OFFICE
OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Response to Evaluation of Incurred Cost Audits Performed by Non-Federal Auditors
for Compliance with Government Auditing Standards (Project No. D2023-
DEV0SO-0010.000)

I appreciate the opportunity to respond to the subject draft report, dated August 23, 2024. I am very concerned about the evaluation and resulting draft report. Therefore, I directed a detailed review of the report and the matters raised by DoD OIG. As described in this memo, we (DCAA) identified substantial areas of disagreement and opportunities for improvement in the draft report and conclusions. Many of these issues would have been more easily resolved, or at least addressed, by greater transparency, objectivity, and communication during DoD OIG's evaluation.

Section 803 of the National Defense Authorization Act for Fiscal Year (FY) 2018¹ provided important authority to support DoD's need for timely and effective incurred cost audits. Although DCAA met the statutory requirement to eliminate any backlog of incurred costs audits by March 31, 2019, the authority to use qualified private auditors (which we refer to throughout the response as independent private auditors (IPAs)) provides great value to DoD audit mission. As intended by Congress, this program authority allows DCAA to focus its audit resources on the Department's highest-risk and more complex tasks while IPAs handle the lower-risk incurred cost audits. Mindful of the legal requirement for DoD to consider audit results without regard to whether DCAA or IPAs performed the audit, DCAA carefully evaluates the qualifications, abilities, and reputation of each IPA before contract award. This assessment includes a review and thorough verification of professional licenses, recent successful external quality checks (i.e., passing peer review within the last year), staff qualifications, past work including a sample of work on attest services, and quality control plans. These steps ensure the Department can trust the quality of the services it receives, and support DoD OIG's responsibilities related to work performed by non-Federal auditors (which we refer to throughout the response as IPAs). These efforts promote confidence in DoD compliance with commercially accepted standards of risk and materiality in the performance of each incurred cost audit, as required by the statute.

DoD OIG's draft evaluation report does not demonstrate that a problem exists with the DCAA IPA program, as the current controls in place are operating as intended, commensurate with the Department's risk associated with this \$5 million program. Moreover, DCAA asserts

¹ Public Law 115-91, codified as amended in relevant part at 10 U.S.C. 3842 ("the Statute").

Defense Contract Audit Agency (cont'd)

that DoD OIG did not consider or address the overall risks to the Government when making its recommendations. If implemented as drafted, the report's recommendations would result in increased costs to the taxpayer, delays to the audit process, and decreasing the interest of small businesses (IPAs) in working with the Federal government.

In summary, DCAA does not concur with any of the recommendations. DCAA fully supports the DoD OIG objective to ensure that IPAs conduct contract audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). However, our detailed review of the matters raised in the draft evaluation report only permits DCAA to agree, in whole or in part, with 7 noncompliances of the 34 reported noncompliances. The 7 instances agreed-to are related to quality of audit documentation, and not related to issues of properly scoping audits, obtaining sufficient appropriate evidence, etc.² As a result, DOD OIG has not proven the findings rise to the level of significant or pervasive noncompliances that warrant meaningful corrective actions.

DCAA Comments on Detailed Findings

As previously noted, DCAA recognizes the importance of the DoD OIG evaluation. Consequently, we conducted a detailed review of each finding to assess the relevant audit and GAGAS provisions to determine areas of agreement and opportunities for program improvements. Based on these reviews, DCAA agrees with a portion of the draft findings (7 of the 34 reported noncompliances). However, our review also identified areas of significant disagreement. In some instances, we identified factual errors. For example, workpapers (W/P) in the audit files that contradicted the reported finding, or erroneous statements that documents or W/Ps were not in the audit W/P packages, when, in fact, they were. We also found interpretive errors. For example, some findings were based on a misinterpretation of a GAGAS provision or applying a personal documentation preference rather than GAGAS requirement as evaluation criteria. In some instances, the draft report's findings provided insufficient detail to permit research necessary to fully understand its positions.

DCAA presents our comments organized by recommendation, followed by our comments organized by type of deficiency. See also Appendix A, "DCAA Provided Response to DoD OIG's Preliminary Findings," which includes DCAA's detailed responses to all deficiencies reported in the initial draft report, dated May 10, 2024. Although Appendix A was intended to respond to all reported deficiencies (including those listed in the final draft report without explanatory narratives), we were not provided sufficient information to provide a detailed review of new examples and amended reasoning not included in the initial draft report.

DCAA's Comments on Recommendations

DoD OIG's Recommendation No. 1:

² DCAA's Comments to Reported Findings (By Type of Deficiency) and Appendix A: DCAA Provided Response to DoD OIG's Preliminary Findings.

Defense Contract Audit Agency (cont'd)

We recommend that the Defense Contract Audit Agency Director:

- a. Determine whether the following eight audit reports that the non-Federal auditors issued without sufficient evidence should be rescinded or revised.
 1. 2019J10100001
 2. 2018A10100008
 3. 2020S10100003
 4. 2019P10100003
 5. 2019R10100001
 6. 2020M10100002
 7. 2018K10100732
 8. 2020K10100432
- b. Document the results of the determination and provide notification to the DoD contracting officers responsible for acting on the incurred cost audits.

DCAA Comments on Recommendation No. 1:

Non-concur. DCAA does not agree with the recommendation that 8 of the 16 audit assignments should be rescinded and the DoD contracting officers notified. The final draft report does not demonstrate 5 of the 8 assignments lacked sufficient evidence. For 3 of the 8 assignments, we agree in-part because the IPAs could have documented their work better. However, these documentation issues do not rise to the level of significant or pervasive noncompliances that would warrant rescinding the audit reports.

DoD OIG's Recommendation No. 2:

We recommend that the Defense Contract Audit Agency Director, in coordination with the Defense Logistics Agency Director:

- a. Review the performance work statement for the contracts with the non-Federal auditors to determine if it provides Defense Contract Audit Agency contracting officer's representatives with clear guidance for reviewing the non-Federal auditor work for compliance with Government Auditing Standards.
- b. Based on the results of the review in Recommendation 2.a, develop and implement a plan to make any necessary revisions to the performance work statement for future contracts with the non-Federal auditors, to ensure that Defense Contract Audit Agency contracting officer's representatives possess the authority and responsibility to review non-Federal auditor work for compliance with Government Auditing Standards before the DoD approves or accepts non-Federal audit results.
- c. Develop and implement a plan to revise the performance work statement in future contracts with the non-Federal auditors to require that:

Defense Contract Audit Agency (cont'd)

1. Non-Federal auditors submit the sample plans before fieldwork begins, along with the audit plan, and
2. The Defense Contract Audit Agency contracting officer's representatives review non-Federal auditor sample plans for compliance with Government Auditing Standards.

DCAA Comments on Recommendation No. 2:

Non-concur. DCAA does not agree with the recommendation to revise the Performance Work Statement (PWS). DoD OIG reviewed the PWS, and on March 19, 2021 stated: "the PWS meets the requirements of the DoD Audit Manual." This statement indicates DoD OIG's present concurrence that the PWS already requires compliance with GAGAS. In addition, we have concerns with the recommendations as they would result in DCAA Contracting Officer Representatives (CORs) inserting themselves in the audit processes of IPAs. The draft recommendation should consider the following:

- a) If a systemic problem exists which requires substantive changes to current DCAA processes.
 - b) Overall risk to the government.
 - c) Increased costs to the taxpayers.
 - d) Adverse effects to IPAs as small businesses resulting in their reluctance to do business with the Federal Government.
 - e) DCAA's current robust processes, which are functioning as intended.
- a. DoD OIG's Evaluation Failed to Demonstrate a Systemic Problem Exists

This recommendation is not warranted because it does not demonstrate that 11 of the 16 assignments lacked sufficient evidence, sufficient sample methodology, sufficient documentation, or sufficient management inquiries to materially affect the quality of these assignments or establish that a systemic failure occurred. DoD OIG non-statistically sampled 16 audits out of 369 audits (4.3 percent), an extremely small selection size in consideration to the overall size of the IPA Program. Nonetheless, DCAA performed a detailed analysis and agreed, in whole or in part, with 7 (from 5 assignments) of the 34 (from 11 assignments) instances of reported noncompliance, 7 workpapers out of approximately 4,100 workpapers (1.7 percent). Even in these cases of agreement, DoD OIG's evaluation did not demonstrate that these findings materially affected the quality of these assignments or established a systemic failure. Therefore, we contend that DoD OIG's selection of 4.3 percent of audits, in which we agree 1.7 percent of workpapers contained immaterial noncompliances, is not sufficient evidence to recommend any systemic changes to the DCAA IPA program.

b. Overall Risk to the Government

DoD OIG's recommendation is excessive and not commensurate to the overall risks to the Government. This program represents approximately \$5 million of cost to the Department per year going to small business contractors. DCAA has, by design and as intended by Congress, assigned historically low dollar, low Government participation rate, and generally low

Defense Contract Audit Agency (cont'd)

risk work to the IPAs. As a result of the low risk, historically these audits produce low questioned costs. Although DCAA does agree with 7 of the 34 reported noncompliances, these cited deficiencies do not rise to the level of significant or systemic and represent little to no risk to the Government. (See Appendix C: Analysis of Risk of Contractors Assigned to IPAs.)

c. Increased Cost to the Taxpayers

The primary purpose of the law authorizing the DCAA IPA program is to have qualified private auditors perform low risk and less complex Incurred Cost Proposal (ICP) assignments which allows DCAA to allocate its resources to higher risk and more complex audits. Requiring DCAA to manage the work of the IPA is contrary to this concept and the statutory framework. Since the inception of the IPA program in FY 2019, IPAs were assigned an average of 121 ICP audits per FY. Implementing quality assurance surveillance plans that require more complex DCAA reviews of audit plans, sample plans, and workpapers for compliance with GAGAS would duplicate the IPAs' own quality management systems and require significant resources from both the IPAs and DCAA. Based on the average workload per DCAA Supervisory Auditor, oversight of 121 assignments would require approximately 12 Full Time Equivalents per year, in addition to the \$5 million taxpayers already pay for the program. The additional cost would be in the millions of dollars that the taxpayers would have to absorb, furthermore, this recommendation would divert limited resources from higher risk assignments. In short, a recommendation for DCAA to serve as the quality management system for IPA firms who already have a peer review rating of "pass" would be contrary to the intent of the DCAA IPA program and its authorizing statute.

d. Adverse Effect to IPAs as Small Businesses

Of the nine IPAs auditing contracts on behalf of DCAA, seven are small business contractors per the Small Business Administration. One of the two non-small business contractors, which has greater resources to dispute findings than the small business IPAs, is also the only one where DoD OIG did not report deficiencies. If adopted, these new requirements for DCAA to review audit plans, sample plans, and workpapers for GAGAS compliance would compel small business IPAs to allocate additional resources to an additional review process. This would impose additional costs to perform audits for the Department which would be passed on to the taxpayers. Several IPAs have informally expressed concerns with thin profit margins on performing this work and do not intend to bid on future contracts in light of these pending recommendations. As a result, implementing DoD OIG's recommendations would have a detrimental impact on the DCAA IPA program as the pool of future bidders, especially small businesses, would dwindle.

e. DCAA's Processes are Robust and Functioning as Intended:

DCAA has a robust set of processes both before contract award and during contract performance. Before contract award, DCAA performs a technical evaluation of the IPA's qualifications to perform the work. DCAA's technical recommendations are provided to DLA for consideration. DCAA's technical evaluations include, but are not limited to:

Defense Contract Audit Agency (cont'd)

- Review of sample work product that demonstrates an examination of government incurred costs performed within the past three years, conducted under attestation standards, applying the appropriate criteria, and comparable in size and complexity to the audit work outlined in the solicitation. The IPA will be disqualified if they cannot demonstrate a sample work product that meets the requirements of the solicitation.
- Ensure IPAs understand the work, as evidenced by the proposed plan for overall implementation and execution of project and assumptions.
- Review evidence of a process for ensuring quality and timeliness of deliverables.
- Review the most current external peer review report and acceptance letter (must show a "pass" rating).
- Review evidence of Certified Public Accountant (CPA) licensure.
- Review resumes of personnel that will comprise the audit team.

During performance, the CORs use a checklist to ensure that completed IPA audit packages meet the requirements of the contract. The checklist is not intended to evaluate the IPAs' professional judgments, but to ensure DCAA understands the testing performed and conclusions reached.

DoD OIG's Recommendation No. 3:

We recommend that the Defense Contract Audit Agency Director, in coordination with the Defense Logistics Agency Director, require non-Federal auditors to include in the quality control plan their planned procedures for complying with Government Auditing Standards, including:

- a. Government Auditing Standards 1.18a, "Examination."
- b. Government Auditing Standards 7.13, "Results of Previous Engagements."
- c. Government Auditing Standards 7.14, "Investigations or Legal Proceedings."
- d. Government Auditing Standards 7.34, "Examination Engagement Documentation."
- e. Standards for Attestation Engagements Number 18, section §205A.31, "Sampling."

DCAA Comments on Recommendation No. 3:

Non-Concur. As DCAA contends that DoD OIG has not established that there is a systemic, material deficiency in the DCAA IPA program (see DCAA Comments on Recommendation No. 2 above), we do not concur with this recommendation for corrective action. The final draft report acknowledges that DoD OIG "did not review the non-Federal auditors' systems of quality control, which is the objective of an external peer review." This recommendation dismisses IPAs' peer-reviewed quality management systems, which are commonly relied on by the private sector and consistent with DoD's statutory requirement to comply with commercially accepted standards of risk and materiality. Consequently, the final draft report does not provide evidence that the IPAs' quality control plans were the cause of their alleged non-compliance with GAGAS. For example, the only IPA that was not cited with any deficiencies does not have a quality control plan listing planned procedures for complying with individual GAGAS requirements. Implementing this recommendation would require each IPA to provide an item-by-item detailed plan. This would discourage participation in the DCAA IPA

Defense Contract Audit Agency (cont'd)

program by imposing additional program costs to perform actions which are unlikely to fix any issues.

DoD OIG's Recommendation No. 4:

We recommend that the Defense Contract Audit Agency Director modify their quality assurance surveillance plan checklist to include a review of workpapers for compliance with Government Auditing Standards, including:

- a. Government Auditing Standards 1.18a, "Examination."
- b. Government Auditing Standards 7.13, "Results of Previous Engagements."
- c. Government Auditing Standards 7.14, "Investigations or Legal Proceedings."
- d. Government Auditing Standards 7.34, "Examination Engagement Documentation."
- e. Standards for Attestation Engagements Number 18, section §205A.31, "Sampling."

DCAA Comments on Recommendation No. 4:

Non-concur. As DCAA contends that DoD OIG has not established that there is a systemic, material deficiency in the DCAA IPA program (see DCAA Comments on Recommendation No. 2 above,) we do not concur with this recommendation for corrective action. This course of action would increase costs to the taxpayer, and adversely impact IPAs as small businesses.

DCAA's Comments to Reported Findings (By Type of Deficiency)

DoD OIG Reported Deficiency No. 1 - Insufficient Evidence - The Non-Federal Auditors Did Not Obtain Sufficient Evidence for 8 of 16 Audits

For 8 of 16 audits, the non-Federal auditors did not obtain sufficient evidence to fully support their reported conclusions in the incurred cost audit reports in accordance with GAGAS 1.18a. GAGAS 1.18a requires auditors to obtain sufficient appropriate evidence to enable the auditors to draw reasonable conclusions on which to base their opinion.

DCAA Comments on Deficiency No. 1 - Insufficient Evidence:

DCAA disagrees with five of the examples and agrees in part with three. For those three, we agree in-part because the IPAs could have documented their work better. GAGAS 1.18a requires IPAs to obtain reasonable assurance by obtaining sufficient, appropriate evidence necessary to draw reasonable conclusions in support of an examination. GAGAS 7.34 requires IPAs to prepare attest documentation that identifies such evidence that supports the IPA's significant judgment and conclusions. These standards rely on the exercise of an IPA's professional judgment to determine the measure of quality and quantity of evidence that is required. GAGAS compliance does not impose additional best practices or require adherence to

Defense Contract Audit Agency (cont'd)

additional standards particular to DoD audit organizations. For the three instances in which DCAA agrees that the IPA could have better their work documented, these documentation issues do not rise to the level of significant or pervasive to warrant rescinding the audit reports. Below we address the two examples illustrated in the report narrative, both of which DCAA refutes. Appendix A (DCAA Provided Response to DoD OIG's Preliminary Findings) includes detailed responses on all eight examples.

For assignment 2020M10100002, on W/P C.07.01, the IPA included the transaction testing completed. Specifically, for the equipment rentals the spreadsheet stated that auditors tested for attributes a. and b. Attribute b is listed as "Confirm expense are FAR and contract Allowable," which the IPA then indicated that they completed. On W/P C07.12 the information contains all the support obtained from the contractor for the equipment rentals and W/P C07.02b shows the contract brief information. Based on this documented information, the IPA briefed the contracts subject to audit to understand the requirements and stated in their fieldwork that they tested support to ensure the expenses were FAR and contract allowable; therefore, there is no factual basis to support a determination that the IPA did not obtain sufficient evidence to determine the equipment was allocable to the contract.

For assignment 2020S10100003, DoD OIG asserts that the IPA accepted direct labor costs as allowable based solely on a review of timesheets; however, the audit package itself includes a review of both the contractor's compensation policy and the executive compensation policy. These would have provided the IPA an adequate basis of understanding compensation, and the policy indicates that the salaries are based on surveys. The audit package also contains significant details of prior audit history and areas of risk, none of which noted unreasonable compensation as an issue. DoD OIG's narrative did not cite any criteria that required the IPA to review salary surveys or perform any specific steps. Therefore, the example does not demonstrate that the IPA did not obtain sufficient evidence to determine that the direct labor costs were reasonable and therefore allowable.

DoD OIG's Reported Deficiency No. 2 - Insufficient Sample - The Non-Federal Auditors Did Not Use a Sufficient Sample Methodology for 4 of 16 Audits

For 4 of 16 audits, the non-Federal auditors did not use a sufficient sample methodology as a basis for their reported conclusions. Statements on Standards for Attestation Engagements number 18 (AT-C) §205A.31, which is incorporated in Government Auditing Standards, requires that if auditors select a sample for transaction testing, the sample size must be sufficient to reduce risk and must be based on a relevant universe to provide a reasonable basis for conclusions about the universe.

DCAA Comments on Deficiency No. 2 - Insufficient Sample:

DCAA disagrees with DoD OIG's examples for two of the four items noted in this finding. For those two, we agree in-part because the IPAs could have documented their work better. However, we maintain that this documentation issue was not material as it did not impact the overall testing performed or conclusions reached. Below we address the two examples

Defense Contract Audit Agency (cont'd)

illustrated in the report narrative, both of which DCAA rebuts. Appendix A (DCAA Provided Response to DoD OIG's Preliminary Findings) includes detailed responses on all four examples.

For the first example, assignment 2018K10100732, DoD OIG's narrative misrepresents the details contained in the workpapers. In W/P 50.6 the IPA documented that they selected 59 items and provided its justification for doing so. Item 6 on that workpaper indicates that three deviations were found but it also went on to explain that the three deviations occurred because the travel voucher did not include documentation of bank payment support. Because the amounts were immaterial, the IPA stated that the sample still provided a reasonable basis for drawing conclusions on the population tested. These facts document relevant considerations by the IPA that were either not considered by DoD OIG in making this finding or were omitted from the explanation.

For the second example, assignment 2019R10100001, DCAA also disagrees with DoD OIG's narrative. In W/P 504.13, the IPA explained the sampling methodology and indicated that the selections were from sub-samples because the trial balance contained lump sum details (meaning that account details were not provided at the transaction level). Based on our review of the workpapers, it is not factually correct that the workpapers did not indicate how the selections were made. Additionally, our review identified 19 total documents that explained the IPA's sampling methodology for all the testing done in the audit. The IPA separated the methodology descriptions for each area tested which made it easy to understand testing performed and explained the methodology for each area tested.

DoD OIG's Reported Deficiency No. 3 – Inadequate Documentation - The Non-Federal Auditors Did Not Sufficiently Document the Work They Performed for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not sufficiently document the work they performed in accordance with Government Auditing Standards. GAG 7.34 requires that auditors prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the examination engagement, to understand the procedures performed, the evidence obtained, and the conclusions reached.

DCAA Comments on Deficiency No. 3 – Inadequate Documentation

DCAA disagrees with DoD OIG's examples for nine of the eleven items noted in this finding. For the two items where we agreed that the documentation from the IPA could have been improved, we maintain that this documentation issue did not impact the overall testing performed or conclusions reached. Below we address the two examples illustrated in the report narrative, both of which DCAA refutes. Appendix A (DCAA Provided Response to DoD OIG's Preliminary Findings) includes detailed responses on all eleven examples.

For assignment 2020J10100007, the IPA used a standard workpaper for materiality calculations. The workpaper itself noted that "the materiality was calculated in accordance with the PPC's materiality worksheet." The PPC's guide is a widely used standard by the private sector as a reputable source material. The IPA had a calculation at the bottom of the spreadsheet titled "individual insignificant items," which included a category called "trivial misstatements."

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While the final draft report accurately states that this was not fully explained on the workpaper, the IPA did indicate the source of the worksheet template used. It is common practice for an audit organization to exclude their own policies in an audit package, and an experienced auditor having no previous connection to the examination engagement would have understood this annotation to a widely used source. DoD OIG should have acquired an understanding of the IPA's internal controls, policies, and procedures used as required by GAGAS. DCAA also noted that although this calculation appeared in other audit packages that explained that it is an industry practice, DoD OIG did not question the use of this practice on those other assignments.

For the second example listed above, assignment 2018A10100008, DoD OIG's narrative above does not accurately describe the information contained in the workpapers. The main issues noted above concern the audit leads and documentation of risk from prior audits. The IPA noted at least one discussion with the DCAA auditors who had historically audited this contractor. This discussion included the audit leads. The IPA also prepared W/P B3.00, which was a summary document showing the information obtained and stating that it would be considered during risk and testing. Additionally, the IPA prepared a document B2.02 which explains their assessment of risk and considers the past audits and audit lead. Based on these facts, the DoD OIG's narrative does not accurately represent the information in the workpapers.

DoD OIG's Reported Deficiency No. 4 – Management Inquiries - The Non-Federal Auditors Did Not Make Inquiries with the DoD Contractor's Management for 11 of 16 Audits

For 11 of 16 audits, the non-Federal auditors did not make inquiries with the DoD contractor's management as required by GAS 7.13 or GAS 7.14. GAS 7.13 requires that auditors ask the contractor's management to identify previous audits, attestation engagements, and other studies that directly relate to the subject matter or a statement about the subject matter of the examination engagement, including whether related recommendations were implemented. GAS 7.14 requires that auditors inquire with the contractor's management on whether any investigations or legal proceedings may impact the audit.

DCAA Comments on Deficiency No. 4 – Management Inquiries

We disagree with DoD OIG's finding in this area for all instances cited. During our review, we found evidence of those inquiries and identified the specific workpaper files where the discussion was documented. We provided a complete list of W/Ps where the work was documented to DoD OIG on May 14, 2024. Below we address the two examples illustrated in the report narrative. Appendix A (DCAA Provided Response to DoD OIG's Preliminary Findings) includes detailed responses on all eleven examples.

For assignment 2019R10100001, the management representation letter supports the inquiry results from management. Item number 6 of the letter states "We have no knowledge of any instances of noncompliance or suspected noncompliance with laws, regulations and contract provisions, including those that affect the Incurred Cost." This item specifically addresses the concern DoD OIG expressed above, particularly when the inquiry revealed that no investigations or legal proceedings were initiated or in process during the period under examination. While the

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letter may be issued at the end of the engagement, that does not mean the inquiry did not occur earlier during the engagement. The letter is simply the formal statement from the contractor on this inquiry which is a common method used by private sector auditors. The absence of more specific language is not sufficient to demonstrate that an inquiry did not occur and does not support a noncompliance determination.

For the second example, assignment 2018K10100732, DoD OIG's narrative is not representative of the contents of the workpapers. The IPA's documentation shows they considered the prior year's audit findings. This was demonstrated in W/P 500 which showed the prior year's audit findings and the questioned labor costs included in the report. In addition, on W/P 60.1, the IPA included an email to the contractor's management which included on item 6 its inquiry about findings and adjustments from the 2017 incurred cost audit (i.e., the previous audit). The contractor's response to this inquiry was included on W/P 60.3, which stated that the findings from 2016 and 2017 were still under negotiation with the DoD contracting officer. Additionally, the labor test procedures on W/P 1100 stated under item 4 that the audit team "examined the job title and the applicable job description to ensure that the person charging time to the grant was allocable to the grant. For those persons selected under Time and Material contracts, we examined the person's qualifications to ensure that he/she was qualified for the labor category billed." Consistent with GAGAS, this sufficiently demonstrates that the current testing was designed to determine if the previous audit finding continued to exist.

It is my sincere hope that the matters described in this memo receive your objective consideration to resolve these areas of disagreement and opportunities for improvement in the final report. DCAA values DoD OIG's role and we are equally committed to the success of the IPA program to support timely and effective incurred costs audits for the Department.

Any questions regarding this letter may be directed to [REDACTED]

Sincerely,



Terri L. Dilly
Director

Enclosure:

Appendix A: DCAA Provided Response to DoD OIG's Preliminary Findings
Appendix B: Summary of DoD OIG's Audit Touchpoints
Appendix C: Analysis of Risk of Contractors Assigned to IPAs

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DCAA Provided Response to DoD OIG's Preliminary Findings (Provided to DoD OIG on June 6, 2024)

No.	Assignment Number	Insufficient Evidence	Insufficient Sample	Inadequate Documentation	Lack of Management Inquires
1	2019J10100001	Disagree	Agree	Agree in part	Disagree
2	2018A10100008	Agree in part	Agree	Disagree	Disagree
3	2020J10100007	n/a	n/a	Disagree	Disagree
4	2020S10100003	Disagree	n/a	Disagree	Disagree
5	2019P10100003	Disagree	n/a	Disagree	Disagree
6	2019R10100001	Agree in part	Disagree	Disagree	Disagree
7	2020R10100011	n/a	n/a	Agree	Disagree
8	2020A10100005	n/a	n/a	Disagree	Disagree
9	2020M10100002	Agree in part	n/a	Disagree	Disagree
10	2018K10100732	Disagree	Disagree	Disagree	Disagree
11	2020K10100432	Disagree	n/a	Disagree	Disagree
	DCAA Findings	3	2	2	0
	DoD OIG Findings	8	4	11	11
	Difference	5	2	9	11

Note: The following are the bulleted items provided by the DoD OIG when DCAA inquired for more details. The list is provided in its entirety and includes some of the examples from the draft report. We included the entire list to show the inconsistencies or differences in the wording between the report and the details received.

1) A/N - 2019J10100001

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any applicable prior audit findings or corrective actions related to prior audit findings (GAGAS 7.13/GAGAS 5.06).

DCAA Comments: We disagree. The audit package contains W/P B4.B.5 there is an excel file titled "Prior audits and inherent risk". This summarized the prior findings and referenced the corrective action plan, which is also included in that zip file. Because this firm also did the 2018 Incurred Cost audit, they used this as a starting point. While this was prepared in the prior 2018 audit, it still summarizes prior audits and action taken. In addition to this information the IPA documented an email communication (W/P G1.B) with the contractor dated 2/5/21 for the prior year Incurred Cost in the audit package which demonstrated the inquiry did occur and includes the contractor's response. Additionally, there

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was an initial data request and there was a question (#7) in Part I that asked about any internal or external audits. . It would be reasonable to assume that if there were any new items presented the IPA would have added them to the list.

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. This question was presented to the contractor in the list of questions included as an attachment to W/P A8. The statement from the OIG is not accurate because the statement is that the inquiry was not made when the documents below show that it clearly was.

- **DoD OIG Finding:** The non-Federal auditor developed a universe to sample from that did not reconcile to the entire population. For example, the direct labor amount used in the materiality calculation was \$3.3M but the EZ Quant universe profile for direct labor totals \$4.1M. The non-Federal auditor was not able to explain the discrepancy (AT-C §205A.31).

DCAA Comments: We agree. We could not find an explanation in the file for the difference in amounts from materiality to testing universe. It should be noted that for direct labor testing, the IPA did test 87 items with no exceptions.

- **DoD OIG Finding:** The non-Federal auditor determined that an assist audit for contract [REDACTED] 17-D-1134 [REDACTED]. DCAA COR instructed them that an assist audit was no longer required because DCAA was unable to locate a cognizant DCAA office. The non-Federal auditor did not adjust their testing to test the costs directly or document why they did not test them directly (GAGAS 1.18).

DCAA Comments: We agree in part. The conversation noted above was not included in the workpapers so we cannot comment specifically on the email. After reviewing the Caseware package we noted that the costs in question for the [REDACTED] were actually included in account 40-800, Professional Services. The sample selection for this account was included on W/P E4 and the testing for this account was included on W/P F.14. To test this account, the IPA performed a walkthrough to understand controls and risk and then they selected 87 items for testing. The universe was about \$15 million and included 537 items. The universe did not include costs from contract [REDACTED] 17-D-1134; however, that would have added only 12 more items totaling about \$1 million based on the general ledger data on W/P B7.A. The testing that was performed on the 87 items disclosed no exceptions and the reason for the assist audit was based on dollars and no other risk factors were noted.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As an example in the F.14 testing workpapers, the non-Federal auditor did not document the workpapers in sufficient detail to determine if the work

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performed would allow them to determine if the costs were in compliance with the audit criteria (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The auditor explained the tests performed in a through i. in the scope section on the first tab and the source section listed the documents obtained. The conclusions reached are stated on this tab also. The second tab lists the transactions reviewed and columns M through U confirm the tests performed. The comments in Column W note the documents the auditor reviewed. GAGAS 7.34 states that *“In addition to the requirements of the examination engagement standards used in conjunction with GAGAS, auditors should prepare attest documentation in sufficient detail to enable an experienced auditor, having no previous connection to the examination engagement, to understand from the documentation the nature, timing, extent, and results of procedures performed and the evidence obtained and its source and the conclusions reached, including evidence that supports the auditors’ significant judgments and conclusions.”* Based on this requirement, the workpaper in question meets this standard. The OIG’s comments indicate that they could not tell what work was performed and based on the information provided above we do not believe that is an accurate statement.

2) A/N - [REDACTED] 2018A10100008

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor’s management about any applicable prior audit findings or corrective actions related to prior audit findings (GAGAS 7.13/GAGAS 5.06).

DCAA Comments: We disagree. This is included as number 19 starting on page 7 of W/P B5.00. Additionally, there was an audit lead included from a 2018 post payment review. This was discussed with DCAA on W/P A5.03 and included as a topic in the Entrance conference with the contractor W/P A5.05. Based on the documentation on W/P B3.07, the DCAA audit team considered the non-compliances immaterial for their audit but wanted them to be considered for the 2018 IC; which they were as indicated on the workpaper. On the workpaper they state that if the finding had been material, they would have expanded testing, issued a form 1 and considered an accounting system noncompliance. Because it was immaterial they did not take any of those actions but instead wrote up this audit lead for consideration during the 2018 IC audit. There would not have been a corrective action taken by the contractor to inquire about because they did not pursue the finding in the post payment review.

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor’s management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. The response to this inquiry is in the Management representation letter from the contractor as items 2, 6 and 7. While the management representation letter might serve more than one purpose in the

Defense Contract Audit Agency (cont'd)

risk work to the IPAs. As a result of the low risk, historically these audits produce low questioned costs. Although DCAA does agree with 7 of the 34 reported noncompliances, these cited deficiencies do not rise to the level of significant or systemic and represent little to no risk to the Government. (See Appendix C: Analysis of Risk of Contractors Assigned to IPAs.)

c. Increased Cost to the Taxpayers

The primary purpose of the law authorizing the DCAA IPA program is to have qualified private auditors perform low risk and less complex Incurred Cost Proposal (ICP) assignments which allows DCAA to allocate its resources to higher risk and more complex audits. Requiring DCAA to manage the work of the IPA is contrary to this concept and the statutory framework. Since the inception of the IPA program in FY 2019, IPAs were assigned an average of 121 ICP audits per FY. Implementing quality assurance surveillance plans that require more complex DCAA reviews of audit plans, sample plans, and workpapers for compliance with GAGAS would duplicate the IPAs' own quality management systems and require significant resources from both the IPAs and DCAA. Based on the average workload per DCAA Supervisory Auditor, oversight of 121 assignments would require approximately 12 Full Time Equivalents per year, in addition to the \$5 million taxpayers already pay for the program. The additional cost would be in the millions of dollars that the taxpayers would have to absorb, furthermore, this recommendation would divert limited resources from higher risk assignments. In short, a recommendation for DCAA to serve as the quality management system for IPA firms who already have a peer review rating of "pass" would be contrary to the intent of the DCAA IPA program and its authorizing statute.

d. Adverse Effect to IPAs as Small Businesses

Of the nine IPAs auditing contracts on behalf of DCAA, seven are small business contractors per the Small Business Administration. One of the two non-small business contractors, which has greater resources to dispute findings than the small business IPAs, is also the only one where DoD OIG did not report deficiencies. If adopted, these new requirements for DCAA to review audit plans, sample plans, and workpapers for GAGAS compliance would compel small business IPAs to allocate additional resources to an additional review process. This would impose additional costs to perform audits for the Department which would be passed on to the taxpayers. Several IPAs have informally expressed concerns with thin profit margins on performing this work and do not intend to bid on future contracts in light of these pending recommendations. As a result, implementing DoD OIG's recommendations would have a detrimental impact on the DCAA IPA program as the pool of future bidders, especially small businesses, would dwindle.

e. DCAA's Processes are Robust and Functioning as Intended:

DCAA has a robust set of processes both before contract award and during contract performance. Before contract award, DCAA performs a technical evaluation of the IPA's qualifications to perform the work. DCAA's technical recommendations are provided to DLA for consideration. DCAA's technical evaluations include, but are not limited to:

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reviewed because the source just stated “supporting documentation”; however, the testing that was performed was detailed on the workpaper. While the documentation could have been improved to explain what documents were specifically requested. The OIG did not indicate that the testing performed was not appropriate.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As one example in WP B2.02, the non-Federal auditor documented audit leads but not how the evidence issues identified during a post payment voucher review impacted their assessment of risk (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The audit lead was discussed at the meeting with DCAA and documented in workpaper B3.00. W/P B3.07 includes a discussion of the audit lead and which workpapers reflect the consideration for testing. As stated above in the first bullet for this assignment, this lead was deemed immaterial by the cognizant DCAA office.

3) A/N - [REDACTED] 2020J10100007

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor’s management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. The management representation letter (W/P F5-2) addresses this issue, number 4, on page 1. While the management representation letter might serve more than one purpose in the audit. The OIG statement above that the IPA did not inquire about any investigative or legal proceedings is not accurate. The letter is the final documentation required from the contractor in the audit, but the contents of the letter would have been discussed prior to that date. It should also be noted that GAGAS 7.14 does not state a specific time during the audit process where this inquiry needs to occur. We provided more details in our position in the assignment above regarding the importance of corroborating written evidence for verbal discussions.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As one example in WP C1-2, the non-Federal auditor performed a materiality calculation and established three trivial misstatements without explaining either in detail (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The note states that the calculation was in accordance with the PPC’s materiality worksheet. This appears to be a template the IPA uses because that calculation was on every tab. It is not a common practice for an audit organization to include their own policies and procedures in an audit package. If there was a question about the practice itself this should have been discussed with the IPA at the beginning of the audit. This materiality

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calculation was also used for assignments 4 and 5 below with the same level of documentation on the workpaper; however, there was no exception noted in those cases.

4) A/N - [REDACTED] 2020S10100003

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. These discussions were documented on W/P D1-1. While the title of the document is related to Fraud discussions, the document can serve more than one purpose. Question 6 relates to knowledge of compliance with laws and regulations. Overall, the DoD OIG's statement that the IPA did not make this type of inquiry is not substantiated and is not factual. If the IPA was talking to the contractor about compliance with laws and regulations, it is reasonable to deduce that any lawsuits relevant to the subject matter would have been discussed.

- **DoD OIG Finding:** The non-Federal auditor did not document the workpapers well enough to determine if they obtained sufficient, appropriate evidence and how they examined to reduce attestation risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. See WP E1 as an example (GAGAS 1.18).

DCAA Comments: We disagree. The auditor included the attributes tested for each type of cost. The tick mark legend includes additional notes for items as needed. The intention of this workpaper was to test controls for disbursement of funds and the "PSSC" tab explains how conclusions were reached. The PSSC explains that the first obtained and documented an understanding of the disbursement process and then selected items for testing. The workpaper shows that they tested 59 Travel items, 33 ODC items and 13 material items. Overall, the contractor tested 360 transactions totaling \$45 million. The DoD OIG is citing GAGAS 1.18, which requires the auditor to obtain sufficient and appropriate evidence. For this audit workpaper specifically, the document number and/or source number was listed for each transaction, which is what was requested from the contractor. The OIG makes the statement above that the IPA needed to explain how they completed each test; however, this is not what is stated in GAGAS and is the OIG's interpretation of the requirement as opposed to the plain reading of the GAGAS language.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As one example in WP E4, the non-Federal auditor did not document in detail how they determined that job descriptions and surveys were not needed to review executive compensation (GAGAS 7.34/GAGAS 5.16a).

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DCAA Comments: We disagree. The auditors clearly explained how they arrived at their conclusions for W/P E4. They used the OMB guidance for compensation caps. The auditor reviewed the Exec Comp policy on W/P B-3-1-3 and summarized it on W/P B3-1, which documented their understanding of the compensation practices. In this case, the DoD OIG is inserting their preference as to how they would conduct the review as opposed to ensuring the work performed met the requirements. The workpapers prepared by the IPA documented their effort performed, which including gaining an understanding the of the compensation practices and determining reasonableness. Based on risk, the IPA determined the testing that was needed. Even after discussions with the OIG, it is unclear why they DoD OIG believes that this additional information was needed based on risk or would have changed the audit results.

5) A/N - [REDACTED] 2019P10100003

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. This was asked during interviews documented on W/P D1-1. While the title of the document is related to Fraud discussions, the document can serve more than one purpose. Question 6 relates to knowledge of compliance with laws and regulations. Overall, the DoD OIG's statement that the IPA did not make this type of inquiry is not substantiated. The wording may not be the exact same language as GAGAS contains but the concept is the same.

- **DoD OIG Finding:** The non-Federal auditor did not document the workpapers well enough to determine if they obtained sufficient, appropriate evidence and how they examined it to reduce attestation risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. See WP E7 as an example (GAGAS 1.18).

DCAA Comments: We disagree. Based on the example listed by the DoD OIG, we looked at W/P E7. The auditor explained the documentation they received on the PSSC and listed the testing performed on the 2nd tab. The sampling plan memo on W/P C2-1 explains why the sample size was appropriate considering the risk factors. The workpaper meets the requirements of GAGAS 7.34 and the comments from the DoD OIG are indicating a preference regarding how they would like to see the workpaper presented which goes beyond the GAGAS requirements.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As an example during the risk assessment, the audit team did not adequately document if or how they planned on testing controls during the fieldwork (GAGAS 7.34/GAGAS 5.16a).

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DCAA Comments: We disagree. GAGAS 7.34 does not require testing of controls. The auditors explained the risk completed, testing performed and conclusions, which is the requirement of 7.34. The D section of the audit package does summarize the internal controls surrounding the audit and what was found during the preliminary audit work; however, it should be noted that control risk was always assessed as moderate or high and the IPA did not say they were relying on internal controls. As a secondary point, in this audit the IPA tested a total of 572 transactions with a value of \$188 million. Based on this information, it is unclear why the DoD OIG felt that the IPA relied on controls and used this to reduce testing. During our discussions with the OIG and the IPA, it appeared that the OIG was focused on one workpaper (D1_2) that was titled Financial Statements Worksheet and had a conclusions that risk in this area was low risk but in the overall risk assessment (W/P D1), which we pointed out above, the IPA did not rely on controls to assess any area of control risk overall as low. This was the workpaper that summarized the overall risk assessment, and, in every area, the control risk was set as moderate or high as evidenced by the table at the bottom of the workpaper.

6) A/N - [REDACTED] 2019R10100001

- **DoD OIG Finding:** The non-Federal auditor confirmed to the OIG that the audit team did not inquire about the results of internal reviews and corrective actions related to those reviews (GAGAS 7.13/GAGAS 5.06).

DCAA Comments: We disagree. The inquiry is noted on W/P 400a on page 13, number 4a and b. auditor initialed and referenced to 320.1. The agenda on that workpaper does show the question was presented at the entrance conference. The workpapers demonstrate that the inquiry was made per the GAGAS requirement.

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. The response to this inquiry is in the Management representation letter on W/P 240 items 4 and 6. While the management representation letter might serve more than one purpose in the audit. The DoD OIG's statement above that the IPA did not inquire about any investigative or legal proceedings is false and misleading. The letter is the final documentation required from the contractor in the audit, but the contents of the letter would have been discussed prior to that date. It should also be noted that GAGAS 7.14 does not state a specific time during the audit process where this inquiry needs to occur. Our position on this issue has been stated above.

- **DoD OIG Finding:** The non-Federal auditor performed sampling/selections by selecting transactions from a "sub-sample" of the total population but did not explain why the "sub-sample" was appropriate for selecting transactions. For a specific example in WP 0503.13, the non-Federal auditor created a "subsample" of \$1.9M from \$5M of Computing

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Direct Costs without explaining why the “subsample” was created or why the judgmental selection was sufficient (AT-C §205A.31).

DCAA Comments: We disagree. The sampling methodology and rationale was presented for this item on W/P 504.13. For this assignment there was a total of 19 sample selections made for testing the assertion. How each sample was selected was determined by risk and the rationale was detailed in the sampling methodology for each area tested.

- **DoD OIG Finding:** The non-Federal auditor did not document the evidence obtained in the workpapers and did not adequately document their examination. For example, during testing of labor in WP 1101.10, the notes state that earning statements and timesheets were reviewed without any explanation that project numbers or hours were compared much less any discussion related to allocability of the costs. Additionally, the non-Federal auditor noted identifying a \$20,000 difference in one transaction which the contractor explained it was due to a bonus being paid. The non-Federal auditor did not document doing any additional analysis related to the bonus payment (GAGAS 1.18).

DCAA Comments: We agree in-part. The workpaper does show how hours were compared and project ID was identified. For bonus item there was a note in the Workpaper about what the difference was and that overall, there were no exceptions taken. During our call with the DoD OIG and the IPA, they did obtain data to validate all the costs. Because there were no exceptions taken, they did not include this documentation in the Caseware package. The IPA indicated that the statement that no exceptions were taken should have conveyed that they followed up and no issues were noted. The DoD OIG was looking for more documentation in the workpaper for this issue. Overall, based on the discussion it appears there could have been additional notes in the workpaper, but the appropriate support was obtained, and the appropriate testing was performed.

- **DoD OIG Finding:** The non-Federal auditor completed the transaction testing workpapers in a consistent format. There was a listing of attributes such as '[e]xpenditure is supported', '[e]xpenditure is reasonable', and '[e]xpenditure is allowable under the contract and pertinent federal regulations'. See WP 2210.10 for an example. The non-Federal did not document the workpapers with any additional information to illustrate how they tested the attributes (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The Attributes section on the Fringe Testing tab explains there is an explanation for the attributes tested for the selected items and the “x” notes that no exceptions were noted with the test. As we have stated numerous times in this response, the testing spreadsheet meets the GAGAS requirements. The DoD OIG expectations for how a workpaper should look indicate more of a preference that goes beyond the requirements, as opposed to ensuring the requirement itself was met.

7) A/N - [REDACTED] 2020R10100011

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- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. The questions on A-3.2 ask about knowledge of fraud (3) and alleged violations (11). The inquiry was also made to the financial management on A-3.3. This workpaper covers both knowledge of fraud and other violations of laws or regulations. There is not a requirement for the inquiries related to fraud and legal proceedings to be in separate documents or occur at separate times. The referenced document satisfies the requirement that the inquiry was made.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As an example in WPs C-6A, C-6B, and C-6C, the non-Federal auditor did not explain their reasoning for how they selected the direct costs samples (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We agree. We could not find a sample plan or explanation on how the samples were selected in the audit package. This does not mean that the samples or testing was not sufficient but just that there was not a clear explanation of how the selections were made.

8) A/N - [REDACTED] 2020A10100005
(The correct A/N [REDACTED] 2020A10100002 in DCAA Systems)

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. This inquiry is presented in W/P A-3.2 (Question 11), A-3.3 (question 9), and A-3.4 (question 3). This workpaper covers both knowledge of fraud and other violations of laws or regulations. There is not a requirement for the inquiries related to fraud and legal proceedings to be in separate documents or occur at separate times. The referenced document satisfies the requirement that the inquiry was made. As stated above for numerous other assignments, the issue appears to be with the wording used as opposed to meeting the intent of the standard.

- **DoD OIG Finding:** To understand if the work completed by the non-Federal auditor was sufficient, we had to request a meeting and walk through of multiple workpapers due to insufficient documentation. As an example in WPs D-3, E1, and F-2 (among others), the non-Federal auditor did not explain the steps performed or evidence examined to determine the costs compliance with the audit criteria (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. For W/P D-3, the attributes tested are listed at the top of the worksheet on the Cost type and T&M tab. Also, evidenced

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examined was listed under the SPSC tab in the sources section. The other W/Ps mentioned have the same format. The workpapers clearly state the evidence examined and steps performed. As we have stated numerous times in this response, the testing spreadsheet meets the GAGAS requirements. The DoD OIG expectations for how a workpaper should look indicate more of a preference that goes beyond the requirements, as opposed to ensuring the requirement itself was met.

9) A/N - [REDACTED] 2020M10100002

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. This inquiry is covered in W/P D05.01, item 3 and W/P D05.02, item 3. While the management representation letter might serve more than one purpose in the audit. The DoD OIG's statement above that the IPA did not inquire about any investigative or legal proceedings false and misleading. The letter is the final documentation required from the contractor in the audit, but the contents of the letter would have been discussed prior to that date. It should also be noted that GAGAS 7.14 does not state a specific time during the audit process where this inquiry needs to occur. Our position on this item has been presented numerous times above in responses for other assignments.

- **DoD OIG Finding:** The non-Federal auditor did not document the evidence obtained in the workpapers and did not adequately document their examination. For example, in WP C07.01 overall, none of the attributes listed are for reasonableness or allocability. We reviewed the evidence the non-Federal auditor included in the workpapers related to Per Diem expenses and did not identify any justifications for travel or travel expense reports or any documentation about what the appropriate GSA approved per diem rates were compared to the expense (GAGAS 1.18).

DCAA Comments: We agree in-part. Attribute b would cover the first concern listed for C07.01. For the per diem, we can see in the additional calculations and reconciliations were done, but the W/Ps do not specifically state where per diem information came from. We acknowledge that the workpaper didn't state the source for these rates. However, there is only one place where per diem rates are published. As we have stated numerous times in this response, the testing spreadsheet meets the GAGAS requirements. The DoD OIG's expectations for how a workpaper should look indicate more of a preference that goes beyond the requirements, as opposed to ensuring the requirement itself was met. If the IPA stated that a test was completed; it is unclear what basis the DoD OIG used to determine that the test did not occur as stated. Based on discussions with the IPA and the DoD OIG, it appears this format for a testing workpaper is very common as an industry practice.

Defense Contract Audit Agency (cont'd)

Appendix A

- **DoD OIG Finding:** The non-Federal auditor did not document the work performed sufficiently in the workpapers. In WP C07.01, the non-Federal auditor does not explain how they examined the evidence to determine the costs compliance with the audit criteria (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The auditor explains the procedures performed and evidence reviewed. The statement by the DoD OIG is not clear as to what they believe is missing. In this audit package the IPA included a majority of the supporting documentation they received and used for testing and the workpaper explains the tests performed. During discussions the DoD OIG indicated that they wanted the IPA to explain how they completed each transaction review; however, the standard does not have that same requirement. Based on statements made it appeared that even if the IPA stated that they completed testing for the attribute, if they did not explain exactly how they did that, the DoD OIG's assumption was that it was not done. This does not appear to be a reasonable approach for this type of review.

10) A/N - [REDACTED] 2018K10100732

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any applicable prior audit findings or corrective actions related to prior audit findings including the 2017 incurred cost audit findings they reference in WP 500 (GAGAS 7.13/GAGAS 5.06).

DCAA Comments: We disagree. Prior years findings were reviewed on W/P 500 and notes that findings will be considered during risk and sample selection. In addition, on W/P 60.1, the IPA included an email to the contractor's management which included on Item 6 inquiring about findings and adjustments from the 2017 ICP audit (i.e., previous audit). The contractor's response to this inquiry was included on W/P 60.3, which stated that the findings from 2016 and 2017 were still under negotiation with the CO. Additionally, the labor test procedures on W/P 1100 stated under item 4 that the audit team "examined the job title and the applicable job description to ensure that the person charging time to the grant was allocable to the grant. For those persons selected under Time and Material contracts, we examined the person's qualifications to ensure that he/she was qualified for the labor category billed." This sufficiently demonstrates that the current testing was designed to determine if the previous audit finding continued to exist. The workpaper states under Source that no other audits were performed which would cover any DCAA or other audits.

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. The response to this inquiry is included in the management letter, item number 11. While the management representation letter

Defense Contract Audit Agency (cont'd)

Appendix A

might serve more than one purpose in the audit. The DoD OIG's statement above that the IPA did not inquire about any investigative or legal proceedings are false and misleading. The letter is the final documentation required from the contractor in the audit, but the contents of the letter would have been discussed prior to that date. It should also be noted that GAGAS 7.14 does not state a specific time during the audit process where this inquiry needs to occur. Any DoD OIG's assertions as to the timing of the inquiry is based on DoD OIG's preference.

- **DoD OIG Finding:** In W/Ps 800.1 and 800.2, the non-Federal auditor performed the selection of transactions including 23 non-labor indirect transactions and 36 non-labor direct transactions. The non-Federal auditor did not explain why these amounts of transactions were sufficient (AT-C §205A.31).

DCAA Comments: We disagree. The sampling rationale for why they selected 59 items is located on 50.6. The risk assessment completed in conjunction with this sample plan provides the risk determined and how that would translate into an appropriate sample size for testing. We believed whatever issues DoD OIG had been based on preference of the look of the workpapers that does not change the quality nor the results of the audit.

- **DoD OIG Finding:** The non-Federal auditor did not document the way the evidence obtained was evaluated to determine compliance with the audit criteria. As an example, in WPs 1450 and 1451, the non-Federal auditor completed testing of direct consultant costs but did not explain how the attributes of reasonableness or allocability were tested (GAGAS 1.18).

DCAA Comments: We disagree. W/P 1451 contains the attributes (A is reasonableness and B is allocability) tested and 1450 explains the evidence reviewed and the procedures performed. The DoD OIG is looking for information in this workpaper that goes beyond the GAGAS requirements. The IPA stated that they tested the support for specific attributes and the DoD OIG is looking for a step-by-step explanation of how that testing was completed. That is not the requirement in GAGAS, nor does it indicate that the IPA did not obtain sufficient and appropriate evidence as the DoD OIG is claiming above by citing 1.18. As stated above for similar issues, the IPA is showing the necessary items stated in GAGAS in the workpaper.

- **DoD OIG Finding:** In WP 1121, the non-Federal auditor tested T&M transactions (worksheet DL Testing, cells AN44-AN72) and determined that the costs complied with the contracts. The non-Federal auditor did not explain any contract requirements or qualifications for employees to support the determination that the costs were allowable (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The PSSC states the testing performed. The sample plan on W/P 1120 states that for T&M the auditor will request the resume or CVs to identify qualifications. This demonstrates the plan to compare resumes

Defense Contract Audit Agency (cont'd)

Appendix A

to contracts. If the DoD OIG is looking for additional corroboration or details in this workpaper, that goes beyond the requirements of GAGAS 7.34 and indicates a preference for workpaper presentation instead of compliance with the requirement itself.

11) A/N - [REDACTED] 2020K10100432

- **DoD OIG Finding:** The non-Federal auditor did not inquire with the contractor's management about any investigative or legal proceedings (GAGAS 7.14/GAGAS 5.10).

DCAA Comments: We disagree. W/P G (DCAA Planning tab) contains this step on line 66 and it says it was completed at the Entrance conf on 2/8/21. On W/P B-03.02, which is the contractor questionnaire there is question B5 on page 4 that asks this question which was completed and signed by the Director of Finance. The workpaper covers both an inquiry of fraud as well as an inquiry of contractor management knowledge of any violations of contract provisions. Any DoD OIG's assertions to separate the inquiry is based on DoD OIG's preference.

- **DoD OIG Finding:** The non-Federal auditor did not obtain evidence to support reasonableness and allocability of material costs. In WP C07.01a, the non-Federal auditor does not have an attribute to test reasonableness or allocability. The non-Federal auditor did not document how they examined any evidence they obtained. We evaluated the evidence contained in the workpapers and determined the non-Federal auditor did not obtain purchase orders or justifications for the expenses (GAGAS 1.18).

DCAA Comments: We disagree. Testing performed is included on Compliance Testing tabs. The evidenced they obtained in included on other tabs in the spreadsheet as well as referenced and included as supporting workpapers. The DoD OIG's statements above indicate that they are looking for the IPA to explain how they examined evidence which goes beyond the requirements of GAGAS which we have stated above. The DoD OIG appears to make inferences of what tests were and were not completed, contrary to the evidence in the workpapers which states that the tests were performed without exception.

- **DoD OIG Finding:** The non-Federal auditor did not document how the audit team considered the applicable Cost Accounting Standards in any of the workpapers (GAGAS 7.34/GAGAS 5.16a).

DCAA Comments: We disagree. The contractor is not subject to CAS compliance. This was stated clearly in the PNM (W/P 03) (section H page 4), but the contract brief review would not have indicated that CAS compliance testing was needed. Even if the CAS compliance sections of FAR (52.230-1 through -6) were noted in the contract brief, FAR states that these requirements do not apply to small business and would only apply in general to any contract where the CAS threshold was met. This contractor is a small business which was stated in the workpaper package. This contractor is also recognized as CAS exempt in the

Defense Contract Audit Agency (cont'd)

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DCAA records. In our discussion, it seemed like the DoD OIG was looking for a statement in the workpapers to state that the contractor was CAS exempt; however, because they did not test for CAS compliance in this audit it would indicate that they understood the appropriate criteria for testing.

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Appendix B

Summary of DoD OIG Audit Touchpoints

1. Formal Notification Letters

- 1) October 3, 2022 - Audit Announcement [REDACTED]
- 2) November 9, 2022 - Audit Re-Announcement – Update on audit sample period-end from 9/1/2019 to 9/30/2022

2. In-Person Meetings at DCAA HQ

- 1) February 7, 2023 – Purpose: DCAA demonstration of system data retrieval [REDACTED]
- 2) July 6, 2023 – Purpose: DCAA brief on COR procedures for selected assignments [REDACTED]

3. Virtual Meetings - MS TEAMS

- 1) November 15, 2022 – DoD OIG's Audit Entrance Conference
- 2) November 29, 2022 – DCAA's Overview of Non-Federal Auditors Program
- 3) July 17, 2023 – DCAA Brief on IPA Program Monitoring Activities
- 4) May 15, 2024 – DCAA Briefed the DoD OIG team DCAA Analysis (Reference Appendix A)
- 5) June 12, 2024 – DCAA hosted a meeting with DoD OIG and IPAs to discuss preliminary results.

4. DCAA Status Update Requests

- 1) May 12, 2023 – Audit on field work stage no details shared.
- 2) June 6, 2023 – Audit on field work stage no details shared.
- 3) September 8, 2023 – Audit on field work stage no details shared.
- 4) March 8, 2024 – team working on draft report no details shared.
- 5) March 20, 2024 – draft findings shared through email.

5. Email Requests for Information

- 1) November 9, 2022 [REDACTED]
- 2) November 16, 2022 [REDACTED]
- 3) November 29, 2023 [REDACTED]
- 4) December 13, 2023 [REDACTED]
- 5) February 15, 2023 [REDACTED]
- 6) March 3, 2023 [REDACTED]
- 7) July 17, 2023 [REDACTED]
- 8) July 18, 2023 [REDACTED]
- 9) July 26, 2023 [REDACTED]
- 10) September 8, 2023 [REDACTED]
- 11) September 20, 2023 [REDACTED]
- 12) November 8, 2023 [REDACTED]
- 13) November 13, 2023 [REDACTED]
- 14) November 22, 2023 [REDACTED]
- 15) December 1, 2023 [REDACTED]
- 16) March 4, 2023 [REDACTED]

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Defense Contract Audit Agency (cont'd)

Appendix C

Analysis of Risk of Contractors Assigned to IPAs

The DoD OIG's recommendations are excessive and not commensurate to the overall risks to the Government. By design, DCAA has assigned historically low Auditable Dollar Volume (ADV), low Government participation rate, and low risk in general (e.g., expected questioned cost to be low from the IPAs work). Although, DCAA does agree, in whole or in part, with 7 of the reported 35 noncompliance, these cited deficiencies represent little to no risk to the Government.

History of Auditable Dollar Volume and Questioned Cost of Subject Contractors								
No.	DLA Contract Number	Assignment Number (A/N)	IPA Dollars Examined (000)	IPA QC (000)	Previous DCAA Dollars Examined (000)	Previous DCAA QC (000)	% of QC to \$ Examined	Reference A/N
1	20-F-0061	2019J10100001	\$ 1,940,586	\$ -	\$ 1,160,000	\$ 110	0.01%	2018J10100002
2	19-F-0084	2018A101000008	\$ 101,982	\$ -	\$ 126,150	\$ -	0.00%	2017A101000004
3	21-F-0025	2020J101000007	\$ 3,020,000	\$ -	\$ 1,160,000	\$ 110	0.01%	2018J101000002
4	22-F-0010	2020S101000003	\$ 293,841	\$ 58	\$ 75,583	\$ 127	0.17%	2019S101000001
5	20-F-0124	2019P101000003	\$ 214,769	\$ -	\$ 39,620	\$ -	0.00%	2018P101000004
6	20-F-0097	2019R101000001	\$ 151,918	\$ -	\$ 145,974	\$ -	0.00%	2018R101000001
7	22-F-0006	2020R101000011	\$ 433,957	\$ -	\$ 516,066	\$ 202	0.04%	2019R101000012
8	22-F-0006	2020A101000005	\$ 187,740	\$ -	\$ 91,000	\$ -	0.00%	2019B101000002
9	21-F-0032	2019Q101000002	\$ 62,116	\$ -	\$ 2,805	\$ -	0.00%	2018G101000002
10	22-F-0002	2020M101000002	\$ 6,375	\$ -	\$ 9,700	\$ 1,093	11.27%	2019M101000012
11	19-F-0031	2018K10100732	\$ 58,021	\$ -	\$ 50,869	\$ 1,480	2.91%	2017K10100732
12	22-F-0002	2020K10100432	\$ 114,362	\$ 1,163	\$ 45,603	\$ -	0.00%	2019B10100432
13	22-F-0003	2020P101000003	\$ 235,791	\$ -	\$ 39,620	\$ -	0.00%	2018P101000004
14	21-F-0080	2020J101000004	\$ 651,874	\$ -	\$ 775,299	\$ -	0.00%	2019J101000004
15	19-F-0035	2018K101000002	\$ 572,910	\$ -	\$ 537,213	\$ -	0.00%	2017K101000015
16	21-F-0073	2020P101000030	\$ 551,910	\$ -	\$ 203,235	\$ -	0.00%	2017P101000013

The contractors examined in 14 of the 16 assignments sampled had previous questioned costs that represent less than 1 percent of total dollars examined. The contractors examined in 2 of the 16 assignments had previous question cost in the amount of \$1,093,000 (11.27 percent of dollars examined) and \$1,480,00 (2.91 percent of dollars examined). However, we consider these contractors to be low risk because the Government participation (5 percent and 10 percent respectively) and the ADVs are low. This means, the previous questioned cost of \$1,093,000 represents the risk to the Government of \$54,650 (\$1,093,000 x 5 percent).

Incurred Cost Proposals Assigned to IPAs by Strata and GFY								
Strata	2019	2020	2021	2022	2023	2024	Total	Percentage of Total
1. <\$5M (0.5%)	1	17	36	37	31	6	128	25%
2. \$5M to <\$50M (5%)		56	70	66	56	7	255	51%
3. \$50M to <\$100M (10%)		11	11	12	11		45	9%
4. \$100M to \$250M (20% / every 5th year)		11	11	12	15	1	50	10%
5. >\$250M to \$500M (25% / every 4th year)		1	2	5	3	2	13	3%
6. >\$500M to <\$1B (25% / every 2 years)		2	2	3	1	1	9	2%
7. \$1B or more (Required Audit)		1	1	1			3	1%
Total	1	99	133	136	117	17	503	100%

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Appendix C

Incurred Cost Proposals Performed by DCAA by Strata and GFY								
Strata	2019	2020	2021	2022	2023	2024	Total	Percentage of Total
1. <\$5M (0.5%)	234	150	91	56	113	20	664	22%
2. \$5M to <\$50M (5%)	400	206	127	107	124	22	986	32%
3. \$50M to <\$100M (10%)	105	60	50	37	44	3	299	10%
4. \$100M to \$250M (20% / every 5th year)	166	74	67	66	60	5	438	14%
5. >\$250M to \$500M (25% / every 4th year)	97	50	42	34	37	5	265	9%
6. >\$500M to <\$1B (25% / every 2 years)	63	34	41	43	39	8	228	7%
7. \$1B or more (Required Audit)	48	34	40	40	42	2	206	7%
Grand Total	1,113	608	458	383	459	65	3,086	100%

To further illustrate, 76 percent of incurred cost proposals assigned to IPAs are in strata 1 and 2. Based on DCAA's Risk Based Sampling of ICPs program, strata 1 and 2 represents the lowest risk to the Government with ADV per ICP that are less than \$50 million. In contrast, DCAA performs assignments that are historically high risk (major defense contractors, large ADV, significant previous questioned cost, and high Government participation rate). To illustrate, DCAA performed 228 ICP assignments in strata 6 and 206 ICP assignments in strata 7, compared to the IPA who performed 9 ICP assignments in strata 6 and 3 ICP assignments in strata 7. Strata 6 and 7 represents the highest risk to the Government with ADV per ICPs that range from \$500 million to over \$1 billion.

Average Questioned Costs DCAA Vs IPA Audit by Dispo GFY where PNM Received (Unrounded)				
Average from GFY 2020 through GFY 2023				
Strata (EAC Dollars)	DCAA	IPA	Difference	Percentage
1. <\$5M (0.5%)	\$ 158,364	\$ 150,381	\$ 7,983	5.04%
2. \$5M to <\$50M (5%)	\$ 549,070	\$ 315,775	\$ 233,295	42.49%
3. \$50M to <\$100M (10%)	\$ 1,113,316	\$ 1,154,667	\$ (41,351)	-3.71%
4. \$100M to \$250M (20% / every 5th year)	\$ 2,996,375	\$ 5,535,750	\$ (2,539,375)	-84.75%
5. >\$250M to \$500M (25% / every 4th year)	\$ 2,672,158	\$ 3,886,000	\$ (1,213,842)	-45.43%
6. >\$500M to <\$1B (25% / every 2 years)	\$ 4,891,844	\$ 491,000	\$ 4,400,844	89.96%
7. \$1B or more (Required Audit)	\$ 3,643,792	\$ 110,000	\$ 3,533,792	96.98%
Sum of Averages	\$ 16,024,918	\$ 11,643,573	\$ 4,381,346	27.34%

Average Questioned Costs Sustained DCAA Vs IPA Audit by Dispo GFY where PNM Received (Unrounded)				
Average from GFY 2020 through GFY 2023				
Strata (EAC Dollars)	DCAA	IPA	Difference	Percentage
1. <\$5M (0.5%)	\$ 124,271	\$ 125,601	\$ (1,330)	-1.07%
2. \$5M to <\$50M (5%)	\$ 340,067	\$ 176,926	\$ 163,141	47.97%
3. \$50M to <\$100M (10%)	\$ 922,224	\$ 1,154,222	\$ (231,998)	-25.16%
4. \$100M to \$250M (20% / every 5th year)	\$ 2,009,425	\$ 305,000	\$ 1,704,425	84.82%
5. >\$250M to \$500M (25% / every 4th year)	\$ 1,991,618	\$ 3,719,000	\$ (1,727,382)	-86.73%
6. >\$500M to <\$1B (25% / every 2 years)	\$ 1,703,589	\$ 491,000	\$ 1,212,589	71.18%
7. \$1B or more (Required Audit)	\$ 2,665,813	\$ -	\$ 2,665,813	100.00%
Sum of Averages	\$ 9,757,007	\$ 5,971,750	\$ 3,785,257	38.80%

Consistent with the authorizing statute, the IPA program has allowed DCAA to allocate resources to higher risk and more complex audits. DCAA's average questioned costs per audit (approximately 27 percent higher) and average questioned costs sustained per audit (approximately 39 percent higher) reflect higher rates than the IPAs. This points to the fact that DCAA performed more complex and large dollar assignments from major contractors that

Defense Contract Audit Agency (cont'd)

Appendix C

require DCAA's contract auditing expertise. In contrast, IPAs are assigned audits of smaller contractors and business systems are less complex. Therefore, Government input is frequently considered by these small businesses as a welcome resource to help them improve their internal controls and knowledge of their staff.

Defense Logistics Agency



DEFENSE LOGISTICS AGENCY
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FORT BELVOIR, VIRGINIA 22060-6221

September 6, 2024

MEMORANDUM FOR INSPECTOR GENERAL (EVALUATIONS FOR SPACE,
INTELLIGENCE, ENGINEERING, AND OVERSIGHT)

SUBJECT: Response to Office of Inspector General Draft Report on Evaluation of Incurred
Cost Audits Performed by Non-Federal Auditors for Compliance with Government Auditing
Standards (Project No. D2023-DEV0SO-0010.000)

This memorandum is intended to satisfy DoD OIG's requirement that DLA provide responses to recommendations 2 and 3 of the subject draft report. As a contract service provider, DLA is not responsible for the establishment of requirement specific standards, which are the focus of these recommendations. Therefore, it is our position that the actions identified in these recommendations are not applicable to DLA. DLA will continue to work with DCAA, as it does with all customers, to ensure documents provided to contractors are sufficient to ensure contract performance.

The point of contact for this evaluation is [REDACTED]

[REDACTED]
[REDACTED]
MATTHEW R. BEEBE
Director, DLA Acquisition

Acronyms and Abbreviations

AT-C	Statements on Standards for Attestation Engagements
COR	contracting officer's representative
DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
GAS	Government Auditing Standards
PWS	performance work statement



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