Inspector General

United States Department of Defense

Oversight Review

March 3, 2009

Key Strategies and Practices for Oversight of DoD Contracted Audit Services

Report No. D-2009-6-003

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Acronyms

COR	Contracting Officer's Representative
GAO/PCIE FAM	Government Accountability Office/President's Council on Integrity and Efficiency Financial Audit Manual
FPDS-NG	Federal Procurement Data System-Next Generation
IPA	Independent Public Accountant
OIG	Office of Inspector General

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March 3, 2009

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Key Strategies and Practices for Oversight of DoD Contracted Audit Services (Report No. D-2009-6-003)

We are providing this report for your information and use.

We performed this review in part to examine how DoD Components manage and conduct oversight of contracted audit services to ensure contractors meet contract requirements and follow Government Auditing Standards. To address this, we determined the extent of DoD's use of contractors to perform audit services. From this information, we selected five contracts for which we performed a detailed review of the capabilities and practices in overseeing the contractors. This report summarizes what we observed and identifies certain key strategies and practices we believe are essential to effective and efficient oversight of contracted audit services.

We appreciate the courtesies extended to the staff. Comments or questions should be directed to Mr. Robert L. Kienitz at (703) 604-8754 (DSN 664-8754), robert.kienitz@dodig.mil.

Carolyn R. Davis
Assistant Inspector General
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Foreword

DoD Instruction 7600.02, "Audit Policies," permits DoD Components to contract for audit services when applicable expertise is unavailable within the DoD audit organization, augmentation of the DoD audit organization's audit staff is necessary to execute the annual audit plan, or temporary audit assistance is required to meet audit reporting requirements mandated by law or DoD Regulation. The Inspector General Act of 1978, as amended, tasks the Office of the Inspector General of the Department of Defense with taking appropriate steps to assure that any work performed by non-Federal auditors complies with the Government Auditing Standards established by the Comptroller General of the United States for audits of Federal establishments, organizations, programs, activities, and functions.

This report summarizes what we observed from the detailed review of the capabilities and practices in overseeing five DoD contracts for audit services, as well as suggests certain key strategies and practices we believe are essential to effective and efficient oversight. It discusses (1) the attributes of a qualified contracting officer's representative, (2) oversight planning, (3) audit monitoring, (4) monitoring contractor independence, and (5) monitoring contractor qualifications. It also highlights the results of our discussions with other Federal offices of inspectors general about the practices they employ when overseeing audit services contracts that could yield benefits to the DoD. Highlights cover (1) communicating expectations and results, (2) establishing detailed milestones, (3) tracking deliverables, and (4) determining lessons learned.

This report is intended for use by DoD contracting and contract oversight officials. While the suggestions presented are not mandatory, we hope that employing them will guide the DoD officials towards taking appropriate steps to monitor and evaluate contractor performance early on and as the audit progresses, thereby addressing and resolving problems that may result in reduced audit quality, missed deadlines, or additional costs before the audit is completed. Doing so will help ensure that the DoD entities contracting for or requesting audit services receive quality, timely audit results that can be relied upon for decision making purposes.

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Introduction

Our review objectives were to determine the effectiveness of and lessons learned from the oversight of DoD contracted audit services and to identify other Federal agencies' practices that could yield benefits to the DoD. We determined the extent of DoD's use of audit contractors by analyzing procurement data on contract actions for auditing services. We also identified audit services contracts for which the DoD Office of the Inspector General is overseeing. For selected contracts, we performed a detailed review of the capabilities and practices to oversee them. This report summarizes the results of our review. See Appendix A for a discussion of the scope and methodology and for prior coverage related to the objectives. This report also highlights the results of our discussions with other Federal offices of inspectors general about their use of contractors to perform audit services and their practices and experiences overseeing audit services contracts.

Background

Contract Oversight. Audit work and reporting quality, timeliness, and compliance with applicable auditing standards are essential elements of successful performance under an audit services contract. Careful oversight of contractor performance can increase the likelihood that these goals are met. This means keeping well-informed of what the contractor is doing; using technical expertise to identify contractor actions or failures to act that clearly affect the quality, progress, or cost of the work; calling the contractor's attention to deficiencies; and determining appropriate actions to deal with deficiencies. These functions are typically delegated to a contracting officer's representative (COR), and the level of effort that will be necessary and the techniques that will be used should be addressed in a COR oversight plan. The type of effort that is appropriate depends on the complexity and scope of the contract, as well as the contract's specific requirements for monitoring, inspection, and acceptance. Factors influencing the degree of oversight include the type of contract, criticality of the requirements, contract performance schedule, contractor's experience with providing the services, contractor's performance history, and the level of the contractor's own inspection system.

Inspector General Oversight. An Office of Inspector General (OIG) may (1) contract with an independent public accountant (IPA) to perform parts of or an entire audit or (2) use the work of an IPA contracted by another entity. For financial audits, the Office of Management and Budget[1] encourages OIGs to use section 650, "Using the Work of Others," of the Government Accountability Office/President's Council on Integrity and Efficiency (GAO/PCIE) Financial Audit Manual (FAM) to help them design and perform oversight procedures when using the work of IPAs. FAM 650 provides that, during

[1] Office of Management and Budget (OMB) Bulletin Nos. 06-03 and 07-04, "Audit Requirements for Federal Financial Statements."

planning, OIG auditors should decide on the amount of assurance or degree of responsibility they wish to provide or accept for the work of an IPA, and based on that decision, the type of report or letter they will issue. The degree of responsibility varies by type of report or letter and generally increases in the order presented below. OIG auditors may decide to:

- not associate the OIG with the IPA's work,[2]
- issue a letter transmitting the IPA's report and expressing either no opinion or negative assurance (i.e., found no instances of material noncompliance with applicable auditing standards) on the IPA's work,
- issue a report that refers to the IPA's report and indicates a division of responsibilities between the IPA and the OIG,
- issue a report that expresses concurrence or non-concurrence with the IPA's report, or
- issue a report that does not mention the IPA's work, thus accepting and representing the work of the IPA as the OIG's work.

FAM 650 also provides that OIG auditors should develop a written plan for reviewing, and if necessary, testing the work done by an IPA. This plan should document the level of review (high, moderate, or low) the auditors believe is necessary based on the type of report or letter they will issue and their evaluation of audit risk, line item materiality, and the IPA's independence, objectivity, qualifications, and history. The level of review increases as the degree of responsibility for the IPA's work, risk, and materiality increases and their confidence about the IPA's objectivity, qualifications, and performance decreases.

An OIG may also provide representation on an audit committee[3] overseeing the work of a contracted IPA. In so doing, the OIG participates as an observer or acts as an expert in a purely advisory, nonvoting capacity to advise entity management on issues based on the specialized knowledge and skills of the OIG auditors.

[2] In this situation, the IPA's report is provided directly to the auditee and significant users. OIG auditors may use this method when the OIG merely procures the audit but is not acting as "the auditor." However, the contracting and contract oversight process generally will require the OIG auditors to evaluate the IPA's independence, objectivity, and qualifications and to monitor performance under the contract.

[3] In the DoD, an audit committee may also be referred to as a "financial audit advisory committee" or an "audit preparedness committee."

Service Contracting Policies

Management Oversight of Service Contracting. Federal Acquisition Regulation 37.102 requires agencies to establish effective management practices in accordance with Office of Federal Procurement Policy Letter 93-1, "Management Oversight of Service Contracting," to prevent fraud, waste, and abuse in service contracting. The policy letter makes agency heads responsible for ensuring that service contracts are awarded and administered in such a manner so that customers receive quality services on time and within budget. It also emphasizes the use of "best practices" techniques when contracting for services and in contract management and administration to help achieve excellence in contractor performance and offers guidance to ensure that agencies use good management practices and contract administration techniques so that:

- sufficient resources are at hand to evaluate contractor performance when the statement of work requires the contractor to provide advice, analysis and evaluation, opinions, alternatives, or recommendations that could significantly influence agency policy development or decision-making;

- quality assurance plans contain enough specifics to adequately monitor contractor performance;

- statements of work specify contract deliverables and require progress reporting on contractor performance; and

- adequate expertise exists within the agency to independently evaluate the contractor's approach, methodology, results, options, conclusions, or recommendations.

Contract Quality Assurance. The Federal Acquisition Regulation Subparts 37.1 and 37.6 emphasize the use of performance standards and quality requirements to ensure that appropriate quality levels are achieved out of the services acquired by contract. Federal Acquisition Regulation 37.6 underscores the need to prepare statements of work that enable the assessment of work performance against measurable performance standards and quality assurance surveillance plans that specify all work requiring surveillance and the methods of surveillance.

Policies on Services by Non-Federal Auditors

Inspector General Oversight of Non-Federal Auditors. The Inspector General Act of 1978, as amended, establishes the duties, responsibilities, and authorities of the Office of the Inspector General of the Department of Defense. The Act gives the Inspector General oversight of non-Federal auditors and makes the Inspector General responsible for establishing guidelines on when it shall be appropriate to use non-Federal auditors and taking appropriate steps to assure that any work performed by non-Federal auditors complies with the Government Auditing Standards established by the Comptroller General of the United States for audits of Federal establishments, organizations, programs, activities, and functions.

DoD Contracting for Audit Services. The DoD OIG established guidelines on the use of non-Federal auditors in DoD Instruction 7600.02, "Audit Policies." The instruction permits DoD Components to contract for audit services when applicable expertise is unavailable within the DoD audit organization, augmentation of the DoD audit organization's audit staff is necessary to execute the annual audit plan, or temporary audit assistance is required to meet audit reporting requirements mandated by law or DoD Regulation. Components are to obtain a review of the solicitation for audit services from the Office of the Assistant Inspector General for Audit Policy and Oversight, DoD OIG, before releasing the solicitation to prospective contractors. The purpose of this review is to ensure that the use of non-Federal auditors is in compliance with DoD Instruction 7600.02 and applicable laws and regulations and that the solicitation requires compliance with applicable auditing standards.

Compliance with Audit Standards. Defense Federal Acquisition Regulation Supplement 237.270 requires that contracts for audit services include a clause requiring the contractor, in the performance of all audit services under the contract, to comply with Government Auditing Standards issued by the Comptroller General of the United States. These standards provide a framework for high-quality audit work by requiring audit organizations to (1) maintain the highest degree of objectivity and independence when performing its work; (2) have staff with the appropriate technical knowledge, skills, and experience conduct the work; (3) maintain a system of quality control for ensuring compliance with applicable auditing standards; and (4) periodically undergo an external peer review of its quality control system. The standards require auditors to adequately plan their work and to obtain sufficient appropriate evidence to support their conclusions and opinions. Also, a written record of the auditors' evidence must be retained in the form of audit documentation and should show the work performed, evidence obtained, and conclusions reached as well as adequate planning and proper supervision.

Results of Review

DoD Components contracting for audit services and the DoD OIG have a shared goal of reasonable assurance of contractor compliance with Government Auditing Standards in the performance of audit work and the reporting of audit results. With this goal in mind, we performed this review in part to examine how DoD Components manage and conduct oversight of contracted audit services to ensure contractors not only meet contract requirements but also follow applicable auditing standards. From the detailed review of five contracts, we learned that oversight capabilities and practices varied and that certain key strategies need to be disseminated. This report summarizes what we observed and suggests the following strategies that we believe are essential to effective and efficient oversight of contracted audit services.

- Designate qualified personnel with significant experience in auditing and appropriate training in contract administration as contracting officers' representatives (CORs).

- Prepare a comprehensive written plan for overseeing contracted audit services.

- Monitor and evaluate the contractor's work as it progresses to resolve problems that may result in reduced audit quality[4], missed deadlines, or additional costs.

- Monitor contractor independence under the standards for each audit performed and secure contractor resolution of any independence impairment identified.

- Monitor the adequacy of the contractor's quality control system and the competence of its staff and address conditions that may jeopardize audit quality.

Other Federal Offices of Inspectors General (OIGs) also contract for audit services and share the common goal of receiving quality services on time, within cost, and compliant with applicable auditing standards and the contract. Therefore, we surveyed selected OIGs about their contract oversight practices. Key practices included:

- communicating expectations and results,
- establishing detailed milestones,
- tracking deliverables, and
- determining lessons learned.

[4] Audit quality as used in this report refers to the auditor's compliance with applicable auditing standards. Auditing standards are generally accepted measures of audit quality. Compliance with standards helps assure users of audit reports that the auditor has adequately performed the audit and that the audit report can be relied upon.

COR Qualifications

Designating CORs with significant auditing experience and appropriate contract administration training is essential for effective oversight of contracted audit services. Defense Federal Acquisition Regulation Supplement 201.602-2 requires that the COR be qualified by training and experience commensurate with the specific technical monitoring and administrative responsibilities delegated to them. Accordingly, CORs designated to perform technical monitoring and administration of a contract for "audit services" should be qualified by training and experience in auditing and contract administration. Preferably this would be the same competencies and skills as experienced auditors who perform audit work in accordance with Government Auditing Standards,[5] as well as training on contract administration functions such as proper file documentation and performance assessment methods. Having personnel with those attributes as CORs is desirable and helps establish a foundation for effective oversight.

The following table summarizes what we observed with regard to the experience and training of the CORs designated to oversee the selected contracts for audit services. The first column identifies desirable but not mandatory attributes in a COR. Also, some of the attributes are more relevant to certain types of audits than others. For example, the professional designation as a certified public accountant is an attribute more relevant to the qualifications necessary in overseeing a financial statement audit than an information assurance audit.[6]

[5] Government Auditing Standards define an "experienced auditor" as an individual who possesses the competencies and skills that would have enabled him or her to perform the audit, which includes an understanding of (1) audit processes, (2) Government Auditing Standards and applicable legal and regulatory requirements, (3) the environment in which the audited entity operates, and (4) issues relevant to the audited entity's environment.

[6] An information assurance audit (also known as a SAS 70/88 review) involves examining a service organization's controls over transactions processing, including information systems controls, and is generally designed to provide user organizations and their auditors with information about the service organization's internal control environment.

Table 1. Qualifications of CORs Designated on Selected Contracts

Attribute	DeCA FS Audit	DFAS FS Audit	MERHCF FS Audit	DDRS IA Audit	DISA IA Audit
Certificate of Training for COR Course	•	•	•	•	•
Certified Information Systems Auditor				•	•
Certified Public Accountant			•	•	
Entity Specific Accounting Experience	•	•			
Entity Specific Auditing Experience			•	•	•
Senior-Level* Accounting Experience	•	•			
Senior-Level* Auditing Experience			•	•	•

DeCA Defense Commissary Agency
DDRS Defense Departmental Reporting System
DFAS Defense Finance and Accounting Service
DISA Defense Information Systems Agency
FS Financial Statements
IA Information Assurance
MERHCF Medicare-Eligible Retiree Health Care Fund

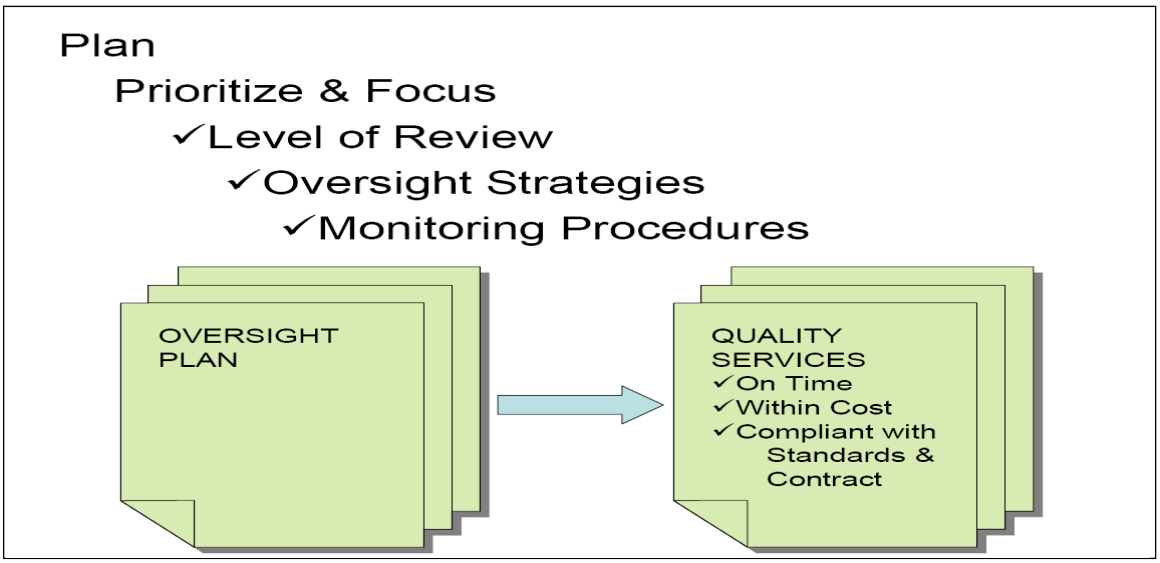
* Held a senior-level position such as partner, director, manager, senior auditor, or senior accountant.

Two of the contracts had CORs that did not have auditing experience beyond three years and the CORs did not specifically engage an audit specialist to assess audit quality or contractor quality control before the contractors issued their draft audit reports. This condition could jeopardize the effectiveness of the contract oversight because the CORs alone may not have enough practical experience in performing and reviewing audit work to be technically competent in spotting deficiencies in the contractors' work early on and as it progresses. Because limited guidance exists as to the specific attributes necessary in a COR, we encourage the use of GAO/PCIE FAM Section 650 as a guide in designating CORs on audit services contracts. FAM 650 basically indicates that staff reviewing the work of auditors under contract generally should have enough experience in the type of audit being performed to understand the judgments that need to be made by the auditors and to interact with the higher levels of the auditors' organization. Further, most of the review generally should be done by or under the direction of an assistant director or a manager who has significant experience in performing and reviewing the type of audit work being performed.

We suggest that components without CORs having significant experience in performing and reviewing audit work of the type performed, seek the assistance of other government personnel with the necessary technical expertise, and have them assess audit quality and contractor quality control.

Oversight Planning

Preparing a comprehensive written plan for overseeing contracted audit services is essential for effective and efficient oversight.



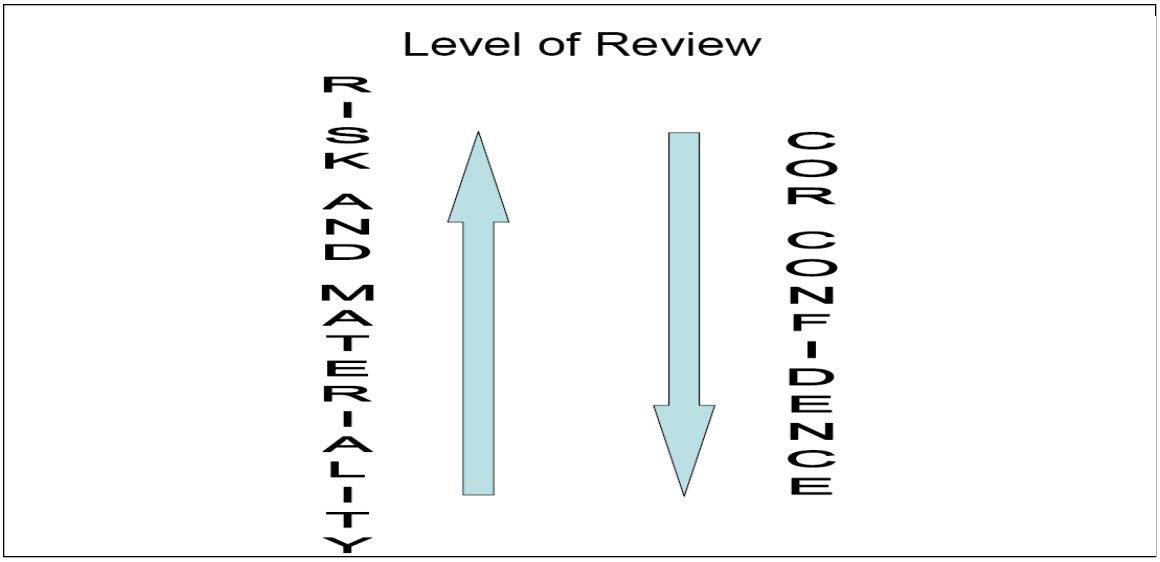
A well-conceived plan documents the level of review, oversight strategies, and monitoring procedures the COR determines is necessary to ensure that the contractor delivers quality services on time, within cost, and compliant with applicable auditing standards and the contract. The plan also documents the COR's assessments of the contractor's objectivity, qualifications, past performance, and system of quality control, as well as assessments of risk and materiality such as technical, cost, and schedule risks;[7] inherent and control risk conditions;[8] and matters individually or collectively significant to the audited entity or primary users of the audited information.[9]

[7] Technical, cost, and schedule risks are potential problem areas posing the greatest risk to the contractor's ability to meet contract requirements and deliver quality services on time and within cost.

[8] Inherent and control risk conditions are, for example, areas with a history of significant audit adjustments, new types of transactions, transactions or accounts subject to significant management judgments (e.g., estimates), new or significantly changed information systems, and areas with known control deficiencies.

[9] Significant matters include, for example, significant line items, individual account balances, or classes of transactions, or components individually generating transactions or account balances at a level significant to the overall entity.

The level of review is a judgment the COR makes and generally increases as risk and materiality increases and the COR's confidence in the contractor's objectivity, qualifications, performance, and quality control decreases.



The strategies and procedures to be carried out are tailored to the planned level of review and include steps to assess audit quality and the contractor's quality control. Having plans designed this way is desirable and helps establish a foundation for effective and efficient oversight by helping CORs prioritize and focus their oversight efforts on areas of higher risk and materiality.

The following table summarizes what we observed with regard to the oversight planning that the CORs on the selected contracts performed. The first column identifies desirable but not mandatory planning actions.

Table 2. Oversight Planning Observed on Selected Contracts

Planning Action	DeCA FS Audit	DFAS FS Audit	MERHCF FS Audit	DDRS IA Audit	DISA IA Audit
Documented Level of Review – L, M, H *			•	•	•
Documented Basis for Level of Review			•	•	•
Documented Strategies, Monitoring Plans	•	•	•	•	•
Documented Steps to Assess Audit Quality			•	•	•
Documented Steps to Assess Quality Control			•	•	•
Scheduled Tasks and Task Milestones	•	•			
Scheduled Deliverables and Delivery Dates	•	•	•	•	•

* L (low), M (moderate), H (high)

The CORs on all five contracts took steps to identify the contractors' work plans and schedules and also prepared written plans of action or schedules for use in monitoring the contractors' performance. However, none of the documented planning actions indicated that the CORs based their strategies, techniques, and procedures on factors of risk, materiality, and contractor traits. For example, it was not evident how the CORs

analyzed and used factors such as the ones listed in the following figure to determine their plan of what needed to be monitored, how, and how often.

Factors in Determining a Contract Monitoring Plan

- ✓ Technical complexity of the contract tasks
- ✓ Degree of cost monitoring needed
- ✓ Urgency of the delivery schedule
- ✓ Nature and extent of inherent risk conditions in the areas under audit
- ✓ Existence of known control weaknesses in the areas under audit
- ✓ Materiality or significance of the areas, items, or sites under audit
- ✓ Objectivity of the contractor and its staff with respect to the audited entity
- ✓ Knowledge, skills, and experience of the contractor's staff for the tasks assigned
- ✓ Contractor's past performance as to quality, timeliness, and cost control
- ✓ Nature and extent of the contractor's quality control policies and procedures
- ✓ Results of the latest external peer review of the contractor's quality control system

Also, the CORs on two contracts did not include in their plans steps to assess audit quality or the extent of the contractor's quality control methods. An example of a step would be to identify the contractor's methods of controlling audit quality, such as supervisory, technical, and other quality control review,[10] and determine whether a selection of the contractor's key audit documentation[11] complies with applicable auditing standards and other relevant requirements and evidences appropriate quality control review.

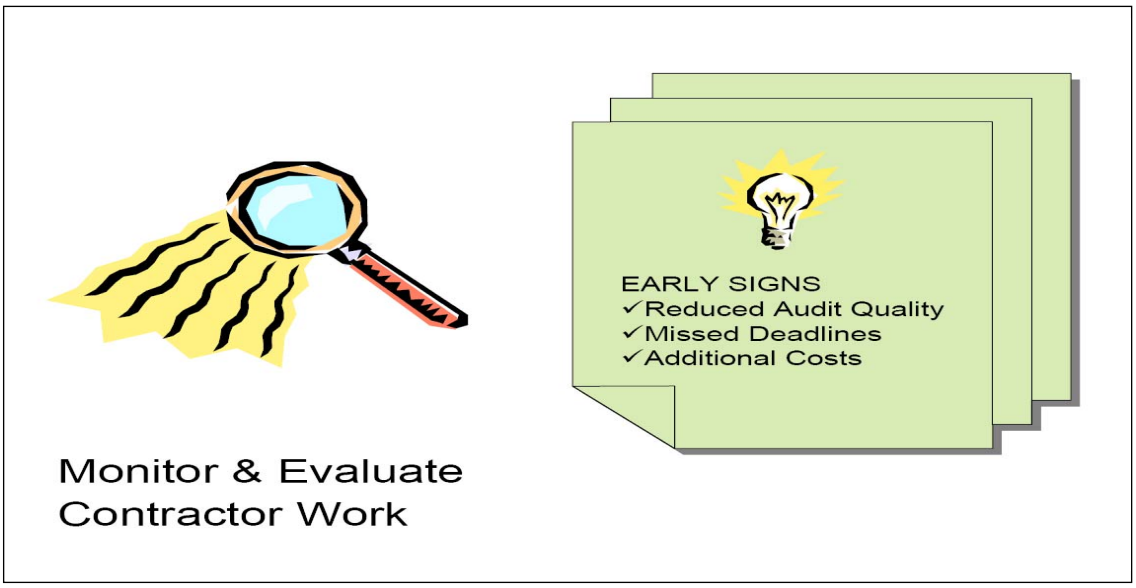
We encourage CORs overseeing DoD contracted audit services to discuss in their written oversight plans their judgments about specific risks, areas of significance, and characteristics of the contractor. CORs should determine the level of review, oversight strategies, and monitoring procedures necessary for effective and efficient oversight. Including determinations on monitoring needs (how and how often) and procedures to assess audit quality and contractor quality control.

[10] Supervisory, technical, and other quality control review includes, for example, supervisory reviews by appropriate first line and second line supervisors; technical reviews by specialists such as actuaries, information technology experts, and statisticians; and quality control reviews by individuals independent of the audit engagement such as concurring review partners and report referencing reviewers.

[11] Key audit documents are, for example, audit plans, work programs, working papers concerning conclusions on principal audit areas, high-risk matters, or major issues, working papers supporting matters reported, and draft and final audit reports.

Audit Monitoring

Monitoring and evaluating the contractor's work as it progresses is essential to effective oversight of contracted audit services.



Monitoring and evaluating the contractor's work helps to identify early signs of any performance problems that may result in reduced audit quality, missed deadlines, or additional costs if not resolved. Monitoring can be accomplished by meetings with the contractor early on about the scope and timelines of the audit work, obtaining progress or status reports from the contractor, and participating in key meetings[12] between the contractor and entity officials. Evaluating performance can be accomplished by reviewing the contractor's plans, key documentation, and written products or deliverables for technical completeness, evidence of quality control review, and compliance with applicable auditing standards and the contract. Documenting actions taken in overseeing a contract is also important. Defense Federal Acquisition Regulation Supplement Procedures, Guidance, and Information 201.602-2 requires that the COR maintain a file containing documentation of their actions in accordance with the authority and responsibilities delegated to them by the contracting officer. Documentation can take many forms, and when done thoroughly, can be very useful in the event of contract dispute by providing a complete picture of discussions held, actions taken, problems identified, and decisions made by the COR as well as any actions by the contractor in response to COR requests.

[12] Key meetings are, for example, opening and completion conferences, planning meetings, meetings discussing high-risk or significant areas, and meetings discussing the contractor's conclusions.

The following table summarizes what we observed with regard to the audit monitoring that the CORs on the selected contracts performed. The first column identifies desirable but not mandatory monitoring actions. In addition, some of the monitoring actions are more relevant to certain types of audits than others. For example, reviewing the contractor's account risk analysis is a monitoring action relevant to overseeing a financial statement audit not an information assurance audit. Also, the nature, timing, and extent of the monitoring actions performed can vary depending on the facts and circumstances of each contract or audit situation and the level of review the COR determines is necessary. For example, monitoring actions can be more extensive during the first year with a new contract or new contractor as well as during the audit of a particular unit or segment(s) of an organization that is unique or complex and less extensive when the COR is thoroughly familiar with the contractor's quality control methods and decides to rely on them.

Table 3. Audit Monitoring Observed on Selected Contracts

Monitoring Action	DeCA[3] FS Audit	DFAS[3] FS Audit	MERHCF FS Audit	DDRS IA Audit	DISA IA Audit
Attended Entrance and Exit Conferences	•	•	•	•	•
Attended Planning Meetings	•	•	•	•	•
Attended Key Meetings Held By Contractor	•	•	•	•	•
Obtained Periodic Progress or Status Reports	•	•	•	•	•
Verified Deliverables Met Contract Terms	•	•	•	•	•
Identified QCs[1] for Ensuring Audit Quality			•	•	•
Verified Whether QCs In Use			•	•	•
Reviewed key audit documentation, e.g.:					
- data, document, sampled items request lists	•	•			
- notices of findings	•	•			
- audit plans			•	•	•
- client (or entity) profile			•		
- general risk analysis			•	•	•
- account risk analysis			•		
- cycle memorandums, flowcharts		•	•	•	
- specific control evaluations			•	•	•
- test procedures/plans			•	•	•
- summary memorandums of work and results			•		•
- draft audit reports	•	•	•	•	•
- final audit reports	•	•	•	•	•
- report cross-references to supporting WPs[2]			•	•	•

[1] QCs (quality controls) such as supervisory, technical, and other quality control types of review.

[2] WPs (working papers) or documentation of work performed, evidence obtained, conclusions reached.

[3] CORs had two or more years experience with the same contractor and relied on the contractor's most recent peer review report in which the external, independent peer expressed an unmodified opinion on its quality control system for ensuring compliance with applicable standards in the conduct of its work.

The CORs on all five contracts successfully monitored the progress of the contractors' audit work as well as the contractors' compliance with contract terms and conditions so that the contractors accomplished the deliverables called for in the contracts. However, we noted that the CORs on two contracts had limited awareness of resources that could assist them in designing and performing their monitoring procedures and may benefit from learning about them. Namely, GAO/PCIE FAM Section 650 and the monitoring tool developed by the Federal Audit Executive Council (FAEC), a subcommittee of the President's Council on Integrity and Efficiency. FAM 650 illustrates the procedures that generally should be performed for high, moderate, and low levels of review of contracted audit work, as well as what generally should be retained as documentation of the procedures performed. The FAEC tool incorporates best practices and lessons learned of Federal OIGs into a detailed program for use in monitoring contracted financial statement audits.

We encourage CORs overseeing DoD contracted audit services to utilize FAM 650 and the FAEC tool as resources in designing and performing their oversight. FAM 650 can be found on the U.S. Government Accountability Office website at www.gao.gov and the FAEC tool can be found on the IGNet website for Federal OIGs at www.ignet.gov/pande/faec1.html.

Monitoring Contractor Independence

Users of audit work done in accordance with Government Auditing Standards should have confidence that the work is objective. For this reason, Government Auditing Standards require that, in all matters relating to the audit work, the audit organization and the individual auditor be free from personal,[13] external,[14] and organizational[15] impairments to independence and avoid the appearance of such impairments. The audit organization and individual auditor must maintain their independence so that their judgments on all issues associated with conducting and reporting on the audit work are impartial and viewed as impartial by knowledgeable third parties.

[13] Personal impairments of auditor independence result from personal relationships or beliefs that might cause the auditor to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings.

[14] External impairments to independence result from factors external to the audit organization, such as pressures (actual or perceived) from management and employees of the audited entity, that may restrict the audit work or deter the auditors from acting objectively and exercising professional skepticism.

[15] Organizational impairments to independence result when the audit organization provides nonaudit services (i.e., services not performed in accordance with Government Auditing Standards) directly supporting an entity's operations thus impairing its ability to meet the overarching independence principles that audit organizations must not (1) perform management functions or make management decisions and (2) audit their own work or provide nonaudit services significantly or materially affecting the subject matter of the audits.

Monitoring the contractor's independence under the standards for each audit performed and securing contractor resolution of any impairment to independence is essential to effective oversight of contracted audit services. User confidence in the results of the audit work is strengthened knowing the contractor followed the independence standards and avoided conflicts that may impair its objectivity. Monitoring contractor independence for each audit performed can be accomplished by obtaining representation from the contractor that it is not impaired by external factors or any past, ongoing, or planned work involving the audited entity and that its audit staff are free of personal impairments to independence. The representation covers the period of the activities under audit to the date of the audit report. If any actual or apparent impairment exists, CORs should ask the contractor to demonstrate that it has resolved the impairment, for example, by substituting staff. Also, CORs should become familiar with the contractor's process for ensuring independence under the standards and determine whether the contractor followed that process for the audit. Doing so helps to determine the extent to which the independence representations of the contractor can be relied upon.

The following table summarizes what we observed with regard to the actions that the CORs on the selected contracts took to monitor the independence of the contractors. The first column identifies desirable but not mandatory monitoring actions.

Table 4. Monitoring of Contractor Independence on Selected Contracts

Monitoring Action	DeCA FS Audit	DFAS FS Audit	MERHCF FS Audit	DDRS IA Audit	DISA IA Audit
Determined Firm Independence For Audit			•	•	•
Determined Staff Independence For Audit			•	•	•
Determined Independence of New Staff	n/a*		n/a*		
Identified Process for Ensuring Independence	•	•	•	•	
Verified If Independence Process In Use					

* n/a (not applicable) because no one joined or replaced members of the initial audit team.

Not all of the CORs determined firm independence and staff independence for each audit performed or determined the independence of staff joining or replacing members of the initial audit team. Specifically, the CORs on two contracts did not obtain any contractor representations as to independence and the CORs on two other contracts did not determine the independence of new staff. In one case this occurred because the CORs relied on the contractors' self-reporting of independence issues in accordance with contractual language requiring the contractors to be independent as defined in standards, as well as clauses precluding them from engaging in work that could be a conflict of interest. Also, not one of the CORs on the five contracts verified whether the contractors' actually put in use a process for ensuring independence under the standards.

We encourage CORs overseeing DoD contracted audit services to identify and document for each audit the contractor's organizational independence and the independence of the individual engagement team members. CORs should identify and document the independence of initial and new staff, and verify the nature and extent of the contractor's methods to maintain independence.

Monitoring Contractor Qualifications

Monitoring the adequacy of the contractor's quality control system and the competence of its audit staff and addressing conditions that may jeopardize audit quality is essential to effective oversight of contracted audit services. User confidence in the quality of the audit work and reported results is strengthened knowing the contractor followed Government Auditing Standards on quality control and staff competence[16] and had its system of quality control reviewed as well as qualified staff perform the work.

Monitoring contractor qualifications can be accomplished by reviewing the contractor's most recent peer review report, the related letter of comments, and the contractor's response to the review report. CORs should adjust the level of their oversight as appropriate based on the significance of any changes to the contractor's quality control policies and procedures since the peer review and any remaining weaknesses in the system.

Monitoring staff qualifications can be accomplished by reviewing resumes to determine whether the staff has the experience necessary for the work such as government auditing experience, experience in the type of audit work, or experience with audits of similar entities, as well as educational and professional qualifications appropriate for their role. If any deficiency in staff expertise is identified, CORs may require the contractor to substitute more qualified staff to ensure the audit is performed by staff who collectively have the knowledge, skills, and experience necessary for that assignment.

The following table summarizes what we observed with regard to the monitoring of contractor qualifications that the CORs on the selected contracts performed. The first column identifies desirable but not mandatory monitoring actions.

[16] Government Auditing Standards require audit organizations to have its system of quality control reviewed by an external, independent peer at least once every 3 years and to ensure each audit is performed by a staff member or team of staff members with sufficient and appropriate technical knowledge, skills, and experience for the work.

Table 5. Monitoring of Contractor Qualifications on Selected Contracts

Monitoring Action	DeCA FS Audit	DFAS FS Audit	MERHCF FS Audit	DDRS IA Audit	DISA IA Audit
Reviewed Most Recent Peer Review Report	●	●	●	●	●
Identified QC[1] Changes Since Review	2	2	●	●	●
Adjusted Oversight If QCs Deficient	2	2	3	3	3
Reviewed Resumes of Managers and Partners	●	●	●	●	●
Reviewed Resumes of Senior Auditors			●	●	●
Required Staff Changes If Jointly Deficient			4	4	4

[1] QC (quality control)

[2] CORs had two or more years experience with the same contractor and relied on the contractor's most recent peer review report in which the external, independent peer expressed an unmodified opinion on its quality control system for ensuring compliance with applicable standards in the conduct of its work.

[3] Not applicable because the most recent peer review report presented an unmodified opinion on the contractor's quality control system.

[4] Not applicable because the audit staff collectively had the technical knowledge, skills, and experience necessary for the audit assignment.

The CORs on all five contracts monitored the adequacy of the contractor's quality control system by reviewing peer review reports and monitored the competence of audit management by reviewing resumes. However, the CORs on two contracts did not assess the background and suitability of the senior auditors for the audit tasks, particularly those supervising the day-to-day operations of the audit, directing staff auditors in the work performed, and reviewing the work of staff.

We encourage CORs overseeing DoD contracted audit services to review the resumes of all supervisory audit staff, including partners, managers, and senior auditors, to ensure that the work is supervised by personnel with the qualifications to ensure audit quality.

Practices of Other Federal OIGs

Other Federal offices of inspectors general also contract for audit services and share the common goal of receiving quality services on time, within cost, and compliant with applicable auditing standards and the contract. Therefore, we wanted to find out about the practices of other Federal OIGs. We judgmentally selected the following seven Federal executive departments and agencies with interagency relationships with the DoD and surveyed their OIGs about the OIGs' use of audit contractors and the OIGs' practices and experiences overseeing audit services contracts.

- Department of Homeland Security
- Department of the Interior
- Department of Justice
- Department of State
- Department of the Treasury
- Department of Veterans Affairs
- National Aeronautics and Space Administration

The OIGs shared with us some of the practices they employ when overseeing contracts for auditing services. Highlights of the practices include:

- communicating expectations and results,
- establishing detailed milestones,
- tracking deliverables, and
- determining lessons learned.

Communicating Expectations and Results. OIGs stated that communication throughout the contract period was important. Communicating expectations at the beginning of the contract through a well-defined statement of work was critical. They identified that it is also important that the contractors communicate their results timely. Several of the OIGs indicated that contractors generally communicated the status of the audit during bi-weekly briefings and progress reports.

Establishing Detailed Milestones. OIGs stated that it was important to set detailed milestones in the statement of work. This provides timelines for the information OIGs receive from contractor for the OIGs to effectively evaluate and make decisions. The milestones help to both get the necessary information in a timely manner and to prevent disputes about contract requirements and due dates for deliverables.

Tracking Deliverables. OIGs established a system for tracking deliverables. The tracking of the deliverables allows the OIG to determine whether the contractor is meeting the requirements of the contract. It also helps to determine whether the contractor is meeting the milestones and whether the OIGs are getting the type of product that is required in the contract.

Determining Lessons Learned. OIGs sought out a process for identifying lessons learned from contracting for auditing services. One of the OIGs had meetings with the contractor and prepared a lessons learned about the audit. This process allowed for both the OIGs and the contractors to comment about the process.

Conclusion

We recognize that limited guidance exists as to specific strategies, techniques, and procedures for overseeing contracted audit services. Therefore, this report contains no recommendations. Instead, it identifies key strategies and practices we believe are essential to effective and efficient oversight. This report is intended for use by DoD contracting and contract oversight officials. While the suggestions presented are not mandatory, we hope that employing them will guide the DoD officials towards taking appropriate steps to monitor and evaluate contractor performance early on and as the audit progresses, thereby addressing and resolving problems that may result in reduced audit quality, missed deadlines, or additional costs before the audit is completed. Doing so will help ensure that the DoD entities contracting for or requesting audit services receive quality, timely audit results that can be relied upon for decision making purposes.

Appendix A. Scope and Methodology

This review was self-initiated. The overall review objective was to determine the effectiveness of and lessons learned from the oversight of DoD contracted audit services. We determined the extent of DoD's use of contractors for performing audit services. Analysis of DoD contracting activity for FYs 2004 through 2006 indicated that the DoD awarded 471 contract actions for auditing services totaling approximately $129.5 million in obligated funds (Appendix B). From this information, we judgmentally selected five contracts for which we performed a detailed review of the capabilities and practices in overseeing them. The following table identifies the contracts and the period of contract oversight we reviewed.

Oversight Reviewed on Selected Contracts

Contract Number	Statement of Work	Short Form	Oversight Done by	Period Reviewed
GS-23F-8127H / HDEC05-06-F-0002	Audit of the Defense Commissary Agency Financial Statements	DeCA FS Audit	DeCA	Jan 06 - Dec 07
MDA230-02-A-0001	Audit of the Defense Finance and Accounting Service Working Capital Fund Financial Statements	DFAS FS Audit	DFAS	Mar 06 - Nov 07
GS-23F-8132H / DO72089	Audit of the Department of Defense Medicare Eligible Retiree Health Care Fund Financial Statements	MERHCF FS Audit	DoD OIG	Mar 06 - Dec 06
GS-23F-8132H / DO35793	Information Assurance and Compliance Audit of the Defense Departmental Reporting System	DDRS IA Audit	DoD OIG	Sep 04 - Oct 05
N00421-05-D-0027	Information Assurance and Compliance Audit of the Defense Information Systems Agency Center for Computing Services	DISA IA Audit	DoD OIG	Dec 05 - Dec 06

We met with contracting officer representatives and other officials who assisted them to discuss the procedures they used to oversee contractors. We also reviewed oversight documentation. We evaluated whether the oversight staff:

- possessed the appropriate technical knowledge, skills, experience, and training necessary to be competent in overseeing the contracted audit services.
- monitored the independence of key staff on the contractor's audit engagement team as well as the organizational independence of the firm.
- monitored the qualifications and experience of key staff on the contractor's audit engagement team.

- monitored the adequacy of the contractor's quality control system.

- planned, performed, and documented their oversight (1) commensurate with the contractor's objectivity and independence, qualifications, performance history, and level of quality control; the complexity and scope of the contract requirements; and the contract performance schedule; and (2) to assure that the contractor complied with applicable auditing standards and the contract.

We performed this review from December 2006 through January 2008.

Use of Computer-Processed Data. We used the Federal Procurement Data System-Next Generation (FPDS-NG) as a source for data on DoD contract actions for auditing services. Since its inception in 1978, FPDS has served as the Government-wide system for collecting Federal procurement data, and almost since its beginning, the Government Accountability Office has reported concerns about it.

The Government Accountability Office expressed concerns in September 2005 about the accuracy of FPDS-NG data. However, we relied on the data to identify contracting actions because we believed that the FPDS-NG was the best available source for that information.

Prior Coverage

Air Force Audit Agency Report No. F2006-0003-FD2000, "Public Accountant Contract Audits," May 30, 2006. The audit included tests of internal controls over quality assurance monitoring, the Public Accountant Contract Audit selection process, and invoice payment accuracy and certification. The audit did not identify any material departures from audit standards or significant administration discrepancies; therefore, the report did not contain recommendations for corrective action.

Appendix B. Analysis of DoD Contracting Activity for FYs 2004 through 2006

Analysis of DoD contracting activity for FYs 2004 through 2006 indicated that the DoD awarded 471 contract actions for auditing services totaling approximately $129.5 million in obligated funds. To determine this, we compiled and analyzed procurement data, as well as identified audit services contracts for which the DoD OIG is overseeing. From this information, we judgmentally selected five contracts for which we performed a detailed review of the capabilities and practices in overseeing them. This appendix summarizes our methods of analysis and selection.

Procurement Data. We compiled data from the Federal Procurement Data System-Next Generation (FPDS-NG). This data consisted of contract actions reported by DoD and non-DoD organizations.[17,18] The following table shows that 451 contract actions with total obligated funds of approximately $109.3 million comprised the data population.

Table B-1. Combined FYs 2004-06 Data on DoD Contract Actions Coded as Auditing Services

Funding Component[1]	Number of Actions[3]	Amount Obligated (millions)
Department of the Army	79	$ 9.1
Department of the Navy	87	14.8
Department of the Air Force	101	14.4
U.S. Army Corps of Engineers-Civil Program	13	0.0
Defense Advanced Research Project Agency	9	10.6
Defense Commissary Agency	1	1.0
Defense Contract Audit Agency	3	0.1
Defense Contract Management Agency	1	0.2
Defense Finance and Accounting Service	46	17.9
Defense Information Systems Agency	5	1.7
Defense Logistics Agency	23	12.5
Defense Threat Reduction Agency	2	0.6
Missile Defense Agency	5	1.9
National Geospatial-Intelligence Agency	3	1.6
Other[2]	73	22.9
	451	**$109.3**

[1] If data element left blank, Funding Agency Code initialized to Contracting Agency Code.

[2] Other DoD Components such as the DoD OIG, Tricare Management Activity, etc.

[3] Contract actions (awards, orders, modifications, etc.) connected to 209 contracts.

[17] The DoD organizations are the Departments of the Army, Navy, and Air Force; Defense Logistics Agency; and Other DoD Agencies.

[18] The non-DoD organizations are the Department of the Interior, Department of the Treasury, General Services Administration, and National Aeronautics and Space Administration. These organizations have memorandums of agreement with DoD relating to interagency acquisition and contracting support.

We analyzed the data to identify contract actions coded "R704" for "Auditing Services" as defined by the FPDS-NG *Product and Service Codes Manual* and the DoD Components who funded the actions.

DoD OIG Data on Audit Services Contracts. We also compiled data from the Program Directors within the Department of Defense Office of the Deputy Inspector General for Auditing, Defense Business Operations. The Directors identified another seven contracts for auditing services totaling 20 actions and approximately $20.2 million obligated for FYs 2004 through 2006. These items are not included in the data shown in Table B-1 because they were not properly coded as "R704" for "Auditing Services" in FPDS-NG. Instead, they were coded as other types of services such as accounting, professional, and research. Therefore, our initial data analysis did not identify them. The following table identifies the procurement items and the service codes applied to them.

Table B-2. Combined FYs 2004-06 Data on Audit Services Contracts Coded as Other Types of Services in FPDS-NG

Contract Number	FPDS-NG Code	Number of Actions	Amount Obligated (millions)
GS-23F-0165N / DO35438	R703	8	$ 5.6
GS-23F-0165N / DO36008	R703	4	0.7
HHM402-04-A-0033 / 0001	AE21, D399	3	2.2
HHM402-04-A-0033 / 0002	R499	1	0.4
N00421-05-D-0020 / 0001-02	R499	2	1.0
N00421-05-D-0025 / 0001	R499	1	6.5
N00421-05-D-0027 / 0001	R499	1	3.8
		20	**$20.2**

AE21 Research and Development/Product or Service Improvement
D399 Other Automatic Data Processing and Telecommunications Services
R499 Other Professional Services
R703 Accounting Services

Selection Process. From the procurement data coded as auditing services, we selected unique procurement instrument ID numbers from the data population for which related actions collectively amounted to $1 million or more in obligated funds. This selection consisted of 29 unique instruments totaling 121 actions and $81.1 million obligated, or 74.1 percent of the approximately $109.3 million obligated for FYs 2004 through 2006. For each instrument, we determined whether the contracted services represented an audit or attestation engagement under Government Auditing Standards by reviewing contract schedules of services and statements of work. We also researched the contractors' Internet sites to determine whether they marketed auditing services. Of the 29, nine inferred contracted audit services from which we judgmentally selected four for detailed review of related oversight. Overall, we discounted those instruments that closed out during our review period, as well as those inferring nonaudit work such as accounting, financial management, or technical analytic support services. From the additional seven audit services contracts identified by the DoD OIG, we judgmentally selected one for detailed review of related oversight. We focused on contracts for which related actions collectively amounted to $1 million or more in obligated funds and discounted those with

work still in progress and work completed before FY 2007. Appendix A identifies the contracts we selected for review.

Inspector General
Department of Defense