



Department of Defense INSTRUCTION

NUMBER 7640.4

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IG, DoD

SUBJECT: Department of Defense Contract Auditing Standards

- References:
- (a) Office of Management and Budget Circular A-73, "Audit of Federal Operations and Programs," June 20, 1983
 - (b) Comptroller General of the United States, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," February 1981
 - (c) President's Council on Integrity and Efficiency, "Interim Quality Standards for Federal Offices of Inspector General," September 1984
 - (d) Institute for Internal Auditing, "Standards for the Professional Practice of Internal Auditing," October 1982

1. PURPOSE

This Instruction implements the requirements of references (a), (b), and (c) and establishes auditing standards that shall be followed by DoD contract audit organizations and auditors in the performance and management of their audit activities.

2. APPLICABILITY

This Instruction applies to the Department of the Army Corps of Engineers and the Defense Contract Audit Agency.

3. POLICY

3.1. It is DoD policy that all contract audits be conducted in accordance with prescribed auditing standards to ensure the acceptance and confidence of

management and external bodies relying on the reported results. The level of acceptance and confidence in audit work is largely dependent upon the quality and reliability of the work performed. Properly developed standards provide criteria for evaluating and measuring the level and quality of an audit organization's operations.

3.2. All DoD contract audit organizations are required to adhere to auditing standards issued by the Comptroller General of the United States (reference (b)). The standards issued by the Comptroller General adopt and incorporate the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards for field work and reporting on financial and compliance audits. The AICPA standards are stated in their "Codification of Statements on Auditing Standards" and future statements are to be adopted herein unless excluded by formal announcement.

3.3. The President's Council on Integrity and Efficiency (PCIE) (reference (c)) and the Institute for Internal Auditors (IIA) (reference (d)) have also promulgated standards that apply to audit activities that are compatible with those issued by the Comptroller General. Whereas the Comptroller General's standards deal primarily with the performance of individual audit projects, the standards issued by PCIE and IIA provide guidelines for managing of audit projects and audit organizations. The Office of Management and Budget (OMB) policies (reference (a)) provide guidance in the areas of organization and staffing, determination of audit priorities, audit plans, and coordination of audit work.

4. RESPONSIBILITIES

4.1. The Assistant Inspector General for Audit Policy and Oversight shall oversee implementation of the audit standards outlined in this Instruction and provide policy changes as warranted.

4.2. The Chief of Engineers, Army Corps of Engineers; and the Director, Defense Contract Audit Agency, shall see that these audit standards are implemented in the audits performed by their organizations.

5. PROCEDURES

The auditing standards to be followed by DoD contract audit organizations and auditors are provided in the enclosure to the Instruction. They are a compilation of six general standards promulgated under references (a) through (d) and special reporting standards for audits of price proposals. Special standards applicable to

other types of contract audits may be issued at a later time. The six general and reporting standards are summarized below and included in their entirety in the enclosure.

5.1. Independence. The audit organization and individual auditors must be free from personal, external, or organizational impairments and shall consistently maintain an independent attitude and appearance.

5.2. Professional Proficiency. The audit organization and each auditor is responsible for maintaining the professional proficiency necessary to perform assigned audit responsibilities. The audit organization shall assign to each audit persons possessing the necessary knowledge, skills, and disciplines to conduct the audit properly.

5.3. Scope of Audit Work. The audit shall include an examination and evaluation of the effectiveness of internal controls, compliance with applicable statutes, and efficiency of operations.

5.4. Performance of Audit Work. The auditor is responsible for planning and conducting the audit assignment, subject to supervisory review and approval.

5.5. Reporting. Auditors shall report their findings in writing. Restrictions on the scope of audits require the auditor to express a qualified or adverse opinion or disclaimer of an opinion on contractors' cost representations taken as a whole. When an adverse opinion is rendered on a price proposal audit, there are specific DoD Federal Acquisition Regulation Supplement requirements to be met, and caution is necessary so not to contradict the adverse opinion rendered. Special standards covering these requirements and the avoidance of contradictive wording are presented in the enclosure.

5.6. Management of Audit Organization. The head of the audit organization is responsible for ensuring that audit work fulfills the general purposes and responsibilities established by law or approved by the head or deputy head of the agency; resources of the audit organization are efficiently and effectively used; and the audit work conforms to DoD auditing standards, policies, and procedures.

6. EFFECTIVE DATE AND IMPLEMENTATION

This Instruction is effective immediately. Forward one copy of implementing documents to the Assistant Inspector General for Audit Policy and Oversight within 120 days.



Derek J. Vander Schaaf
Deputy Inspector General

Enclosures - 1

1. General Auditing Standards for DoD Contract Audit Organizations

E1. ENCLOSURE 1

GENERAL AUDITING STANDARDS FOR DOD CONTRACT AUDIT ORGANIZATIONS

The six general standards address independence, professional proficiency, scope of audit work, performance of audit work, reporting, and management of the audit organization. Each is described below:

E1.1. INDEPENDENCE.

The audit organization and the individual auditors must be free from personal, external, or organizational impairments and shall consistently maintain an independent attitude and appearance.

E1.1.1. Personal Impairments. In some circumstances, auditors cannot be impartial because of their view or personal situation. While such impairments apply to individual auditors, they may also apply to the audit organization. These circumstances include, but are not limited to, the following:

E1.1.1.1. Official, professional, personal, or financial relationships that might cause the auditor to limit the extent of the inquiry, to limit disclosure, or to weaken audit findings.

E1.1.1.2. Preconceived ideas about individuals, groups, organizations, or objectives of a particular contractor that could bias the audit.

E1.1.1.3. Previous involvement in a decision-making or management capacity that would affect current operations of the entity being audited.

E1.1.1.4. Biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of Government.

E1.1.1.5. Financial interests, direct or substantially indirect, in the audited entity or contractor.

E1.1.2. External Impairments. Factors external to the audit organization can restrict the audit or interfere with the auditor's ability to form independent and objective opinions and conclusions. For example, an audit will be adversely affected

and the auditor will not have complete freedom to make an independent and objective judgment under the following conditions:

E1.1.2.1. Undue interference in the recruitment and assignment of audit personnel.

E1.1.2.2. Undue restrictions on funds or other resources dedicated to the audit organization which could prevent the auditors from performing essential work.

E1.1.2.3. Authority to overrule or to unduly influence the auditor's judgment as to selection of what is to be audited, determination of the scope or approach of the audit, content of any resulting report, or resolution of audit findings.

E1.1.2.4. Influences that jeopardize the auditor's continued employment for reasons other than competency or the need for audit services.

E1.1.2.5. Interference with access to records, reports, audits, reviews, documents, papers, recommendations, or other material needed to carry out the audit or denies the auditor the opportunity to obtain explanations from officials and employees.

E1.1.2.6. Political pressures that affect the selection of areas for audit, the performance of those audits, and the objective reporting of conclusions without fear of censure.

E1.1.3. Scope Impairments. When factors external to the audit organization and the auditor restrict the audit or interfere with the auditor's ability to form objective opinions and conclusions, the auditor shall attempt to remove the limitation or, failing that, report the limitation.

E1.1.4. Organizational Placement. The audit organizations shall report to the highest appropriate DoD echelon to ensure its independence of staff or line management responsible for the acquisition function.

E1.1.5. Objectivity. Auditors shall be objective in performing contract audits. Objectivity is an independent mental attitude maintained when performing audits. Auditors shall not subordinate their judgment on audit matters to others.

E1.2. PROFESSIONAL PROFICIENCY.

Professional proficiency is the responsibility of the audit organization and each auditor. The audit organization shall assign to each audit those persons who collectively possess the necessary knowledge, skills, and disciplines to conduct the audit properly.

E1.2.1. Due Professional Care. Due professional care shall be used in conducting the audit and in preparing the related reports.

E1.2.1.1. The audit organization and the auditor are responsible for using professional standards to audit contractors proposals, costs, operations, and claims.

E1.2.1.2. Due professional care calls for the application of the care and skill expected of a reasonably prudent and competent auditor in the same or similar circumstances. Professional care should, therefore, be appropriate to the complexities of the audit being performed. In exercising due professional care, auditors should be alert to the possibility of intentional wrongdoing, errors and omissions; inefficiency; waste; ineffectiveness; and conflicts of interest. They should also be alert to those conditions and activities where irregularities are most likely to occur. In addition, they should identify inadequate or inefficient controls and recommend improvements to promote compliance with acceptable procedures and practices or contractual provisions.

E1.2.1.3. Due care implies reasonable care and competence, not infallibility or extraordinary performance. Due care requires the auditor to conduct examinations and verification to a reasonable extent, but does not require detailed audits of all transactions. Accordingly, the auditor cannot give absolute assurance that noncompliance or irregularities do not exist. Nevertheless, the possibility of material irregularities or noncompliance should be considered whenever the auditor undertakes an auditing assignment.

E1.2.1.4. An auditor suspecting fraud or other illegal acts shall inform the appropriate DoD criminal investigative organization.

E1.2.1.5. Exercising due professional care means using good judgement in choosing tests and procedures and in preparing reports. To this end, the auditor should consider the following:

E1.2.1.5.1. Extent of audit work needed to achieve audit objectives.

E1.2.1.5.2. Relative materiality or significance of matters to which

audit procedures are applied.

E1.2.1.5.3. Adequacy and effectiveness of contractor internal controls.

E1.2.1.5.4. Cost of auditing in relation to potential benefits.

E1.2.1.5.5. Tests and procedures designed to meet planned objectives and the competency of persons assigned to perform the audit.

E1.2.1.5.6. Objectivity of findings and conclusions based on all pertinent facts.

E1.2.1.5.7. Support of reported facts and conclusions by information obtained and developed during the audit.

E1.2.2. Auditor Qualifications. Auditors shall possess the knowledge, skills, and discipline essential to the performance of audits. The following knowledge and skills are considered essential:

E1.2.2.1. Proficiency in applying professional auditing standards, procedures, and techniques in performing audits. This means the ability to apply knowledge to situations likely to be encountered and to deal with them without extensive recourse to technical research and assistance.

E1.2.2.2. Proficiency in accounting principles and techniques for auditors who work extensively with financial records and reports.

E1.2.2.3. An understanding of management principles is required to recognize and evaluate the materiality and significance of deviations from good business practice. This means having the ability to apply broad knowledge to situations likely to be encountered, to recognize significant deviations, and to carry out the research necessary to arrive at reasonable solutions.

E1.2.2.4. An appreciation of the fundamentals of such subjects as accounting, economics, quantitative methods, computerized information systems, procurement, and acquisition regulations.

E1.2.2.5. A knowledge of regulations, directives, instructions, and other publications from the Comptroller General, the Office of Management and Budget, the Department of Defense, the U.S. Congress, and other authoritative bodies.

E1.2.2.6. A working familiarity with the organization, contracts, activities, and functions of each major contractor. A knowledge of each contractor must be in sufficient depth to assess whether contract costing practices comply with contract terms, and to identify problems to the degree required for a particular task or set of responsibilities.

E1.2.2.7. A knowledge of Government policies, requirements, and guidelines related to a particular task.

E1.2.2.8. Managerial skills for supervisors and team leaders.

E1.2.3. Human Relations and Communications. Auditors shall be skilled in dealing with people and in communicating.

E1.2.3.1. Auditors should understand human relations and maintain satisfactory relationships with auditees.

E1.2.3.2. Auditors should be skilled in oral and written communications so that they can convey clearly and effectively such matters as audit objectives, evaluations, conclusions, and recommendations.

E1.2.4. Continuing Education. Auditors shall maintain their technical competence through continuing education. Auditors are responsible for continuing their education to maintain their proficiency. They should keep informed about improvements and current developments in auditing standards, procedures, and techniques. Continuing education may be obtained through membership and participation in professional societies; attendance at seminars, college courses, and Federal and in-house training programs; and participation in research projects.

E1.2.5. Compliance with Standards of Conduct. Auditors shall comply with professional standards of conduct. Auditors shall maintain high standards of honesty, objectivity, diligence, and loyalty when performing their work.

E1.3. SCOPE OF AUDIT WORK.

The scope of audit shall include an evaluation of the effectiveness of internal controls, compliance with applicable statutes, and the efficiency of operations.

E1.3.1. Reliability and Integrity of Information. Auditors shall review the

reliability and integrity of financial operating information and the means used to identify, measure, classify, and report such information. Information systems provide data for decision-making, control, and compliance with external requirements. Therefore, auditors should examine information systems and, as appropriate, ascertain whether:

E1.3.1.1. Financial and operating records and reports contain accurate, reliable, timely, complete, and useful information.

E1.3.1.2. Controls over recordkeeping and reporting are adequate and effective.

E1.3.2. Compliance with Contract Terms, Laws, and Regulations. Auditors shall review contractors' financial and accounting systems and related operations to ensure compliance with applicable laws, regulations, and contractual terms.

E1.3.2.1. Contractors are responsible for establishing the means to ensure compliance with contractual terms, applicable law, and regulations. Auditors are responsible for determining whether the means adopted are adequate and effective and whether the contractors are complying with the requirements.

E1.3.2.2. The auditor shall determine whether the cost representations for either incurred or estimated costs of a contractor are presented in accordance with cost accounting standards, acquisition regulations, and generally accepted accounting principles.

E1.3.3. Economical and Efficient Use of Resources. Auditors shall appraise the economy and efficiency with which contractor resources are managed.

E1.3.3.1. The contractor is responsible for setting operating standards to ensure economical and efficient use of resources. Auditors are responsible for determining whether:

E1.3.3.1.1. Operating standards have been established for measuring economy and efficiency.

E1.3.3.1.2. Established operating standards are understood and are being met.

E1.3.3.1.3. Deviations from operating standards are identified, analyzed and communicated to those responsible for corrective action.

E1.3.3.1.4. Corrective action has been taken.

E1.3.3.2. Audits related to the economical and efficient use of resources shall identify such conditions as:

E1.3.3.2.1. Underused facilities.

E1.3.3.2.2. Nonproductive work.

E1.3.3.2.3. Procedures that are not cost-effective.

E1.3.3.2.4. Overstaffing and understaffing.

E1.3.3.2.5. Unneeded or costly procurements.

E1.4. PERFORMANCE OF AUDIT WORK.

The auditor shall plan and conduct the audit assignment, subject to supervisory review and approval.

E1.4.1. Planning the Audit. Auditors shall plan and document the following in each audit:

E1.4.1.1. Audit objectives and scope of work.

E1.4.1.2. Background information about the contractor's activity to be audited.

E1.4.1.3. Resources necessary to perform the audit.

E1.4.1.4. Communication with all who need to know about the audit.

E1.4.1.5. A survey, as appropriate to become familiar with the contractor to be audited, to identify areas for audit emphasis, and to invite auditor comments and suggestions.

E1.4.1.6. How, when, and to whom audit results will be communicated.

E1.4.1.7. Approval of the audit work plan.

E1.4.1.8. Coordination with other Government auditors, when appropriate,

concerning work already done and other work that may be intended in the future.

E1.4.2. Audit Program. A written audit program shall be prepared for each audit and is essential to conducting audits efficiently and effectively. The audit program shall generally include the following information:

- E1.4.2.1. Introduction and background.
- E1.4.2.2. Purpose and scope.
- E1.4.2.3. Objectives.
- E1.4.2.4. Definition of terms.
- E1.4.2.5. Special instructions.
- E1.4.2.6. Audit procedures.
- E1.4.2.7. Name of performing auditor and date procedures are performed.
- E1.4.2.8. Reference to the workpaper documenting the work performed.

E1.4.3. Supervision. The audit organization shall ensure that audits are properly supervised. Supervision shall be exercised at each level of the audit organization to provide quality control over audit assignments and must be appropriately documented.

E1.4.3.1. Supervision is a continuing process, beginning with planning and ending with the preparation of the final audit report. It includes:

- E1.4.3.1.1. Providing subordinates with suitable instructions at the outset of the audit and approving the audit program.
- E1.4.3.1.2. Ensuring that the approved audit program is carried out unless deviations are both justified and authorized.
- E1.4.3.1.3. Ensuring that the audit conforms with professional auditing standards.
- E1.4.3.1.4. Determining that audit working papers adequately support the audit findings, conclusions, and reports.

E1.4.3.1.5. Ensuring that audit reports are accurate, objective, clear, concise, constructive, and timely.

E1.4.3.1.6. Assigning the work commensurate with the abilities of the assigned staff.

E1.4.3.1.7. Determining that audit objectives are being met.

E1.4.3.2. Supervision includes sufficient interim checks to determine whether audit projects are on schedule and are being executed in accordance with plans, so that necessary adjustments can be made.

E1.4.3.3. Appropriate evidence of supervision shall be documented and retained.

E1.4.3.4. The extent of supervision required will depend on the proficiency of the auditors and the difficulty of the audit assignment.

E1.4.4. Examining and Evaluating Information. Auditors shall collect, analyze, interpret, and document information to support the audit results.

E1.4.4.1. Information shall be collected on all matters related to the audit objectives and scope of work.

E1.4.4.2. Information shall be sufficient, competent, and relevant to provide a sound basis for audit findings and recommendations. "Sufficient" information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. "Competent" information is reliable and the best attainable through the use of appropriate audit techniques. "Relevant" information supports audit findings and recommendations and is consistent with the objectives for the audit.

E1.4.4.3. Audit procedures, including the testing and sampling techniques employed, shall be selected in advance, where practicable, and expanded or altered if circumstances warrant.

E1.4.4.4. The process of collecting, analyzing, interpreting, and documenting information shall be supervised to provide reasonable assurance that the auditor's objectivity is maintained and that audit goals are met.

E1.4.4.5. Working papers that document the audit shall be prepared by the auditor and reviewed by audit supervisory personnel. These working papers shall record the information obtained and the analyses made and should support the bases for the findings and recommendations to be reported. The working papers shall be complete, accurate, clear, understandable, legible, neat, and contain relevant information.

E1.4.5. Internal Controls. During the audit, a study and evaluation shall be made of the internal control systems (accounting and administrative controls) applicable to the contractor organization.

E1.4.6. Auditing of Computer-Based Systems. The auditor shall:

E1.4.6.1. Review general controls in data processing systems to determine whether:

E1.4.6.1.1. The controls have been designed according to management direction and known legal requirements.

E1.4.6.1.2. The controls are operating effectively to provide reliability of, and security over, the data being processed.

E1.4.6.2. Review application controls of installed system/applications upon which the auditor is relying to assess their reliability in processing data in a timely, accurate, and complete manner.

E1.4.7. Fraud, Abuse, and Illegal Acts. Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts. If such evidence exists, audit steps and procedures shall be taken to identify the effect on the contractor's cost representations, operations, or programs. Investigative authorities shall be promptly alerted of any irregular activity and a formal report issued on the suspected conditions.

E1.4.8. Audit Followup. Auditors shall follow up to ascertain that corrective action is taken on recommendations in operations and systems audit reports.

E1.5. REPORTING.

Auditors shall report the results of their audit work in writing.

E1.5.1. Form. Written reports are necessary to:

E1.5.1.1. Communicate the results of audits to appropriate acquisition officials.

E1.5.1.2. Make the findings and recommendations less susceptible to misunderstandings.

E1.5.1.3. Facilitate follow-up to determine whether appropriate corrective measures have been taken.

E1.5.2. Distribution. Written audit reports shall be submitted to the appropriate officials of the organizations requesting the audit or the designated administrative authority for the particular contractor. Copies of the reports shall also be sent to officials who may be responsible for taking action on audit findings and recommendations and to others authorized to receive such reports.

E1.5.3. Timeliness. Reports shall be issued on or before the date specified by regulation or special arrangement with the requesting office. If the designated date cannot be met, the reason for the delay must be communicated to the appropriate official and an extension obtained.

E1.5.4. Report Presentation. The audit report shall:

E1.5.4.1. Present factual data completely, accurately, and fairly. Include only information, findings, and conclusions that are adequately supported by sufficient evidence in the auditor's working papers to demonstrate or prove the basis for the matters reported and their correctness and reasonableness.

E1.5.4.2. Present findings and conclusions in a convincing manner.

E1.5.4.3. Be objective.

E1.5.4.4. Be written as clear and simple as the subject matter permits.

E1.5.4.5. Be concise but, at the same time, in enough detail to be understood by users.

E1.5.4.6. Place primary emphasis on improvement rather than on criticism of the past. Critical comments should be presented in a balanced perspective

considering any unusual difficulties or circumstances faced by the contractor.

E1.5.5. Report Contents. The reports shall express an opinion regarding the cost representation or operational/functional area taken as a whole. In all cases, the report shall clearly indicate the extent of the auditor's examination and the degree of responsibility taken. The reports shall include:

E1.5.5.1. Cost Representations.

E1.5.5.1.1. A statement that the examination was made in accordance with generally accepted government auditing standards as supplemented by the DoD contract auditing standards.

E1.5.5.1.2. A description of the basis for each element of the contractor's cost representation.

E1.5.5.1.3. A statement on the scope of review and basis of opinion on each element of the cost representation.

E1.5.5.1.4. A description of material weaknesses found in the internal control system (accounting and administrative controls).

E1.5.5.1.5. Pertinent views of responsible contractor officials concerning the auditor's findings, conclusions, and recommendations, except for reports on forecasted costs requiring negotiation. The conclusions and recommendations on the audit of forecasted costs shall not be discussed with the contractor unless specifically requested to do so by the contracting officer.

E1.5.5.1.6. A cautionary statement of any instances of suspected contractor fraud or illegal acts that could adversely affect the Government if the contracting officer is not alerted of the condition. Fraud or illegal acts are to be reported separately so not to restrict the use of the audit report for the purpose it is issued. However, an audit report shall not be issued on any part of a representation containing fraudulent claims pending notification of and coordination with the cognizant investigative agency.

E1.5.5.2. Operational/Functional Areas.

E1.5.5.2.1. A statement that the review was made in accordance with generally accepted government auditing standards as supplemented by the DoD contract auditing standards.

E1.5.5.2.2. A description of the scope and objectives of the audit.

E1.5.5.2.3. A description of material weaknesses found in the internal control system (accounting and administrative controls).

E1.5.5.2.4. A statement of those items tested for compliance and a clear indication of the extent of noncompliance.

E1.5.5.2.5. A cautionary statement of any instances of suspected contractor fraud or illegal acts that could adversely affect the Government if the contracting officer is not alerted of the condition. However, fraud or illegal acts are to be reported separately so not to restrict the use of the audit report for the purpose it is issued.

E1.5.5.2.6. Recommendations to correct deficiencies noted in the audit and to improve the operation or function. The underlying cause and effect of the deficiencies must be included to assist in implementing corrective actions.

E1.5.5.2.7. Pertinent views of responsible contractor officials concerning the auditor's findings, conclusions, and recommendations. When possible, these should be obtained in writing.

E1.5.5.3. Circumstances Resulting in Qualified, Adverse Opinion, or Disclaimers of Opinion - Scope Limitation

E1.5.5.3.1. General. The auditor can express an unqualified opinion only if the examination has been conducted in accordance with government/DoD auditing standards and the auditor has been able to apply all the procedures considered necessary in the circumstances. The auditor's decision to qualify the opinion or to disclaim an opinion or to render an adverse opinion because of a scope limitation depends on an assessment of the importance of omitted procedures in forming an opinion.

E1.5.5.3.2. Price Proposal Report Opinions. When the submitted cost or pricing data are acceptable and comply with the FAR and CAS the auditor's opinion shall state: the offeror has submitted adequate cost or pricing data, the proposal has been prepared in accordance with the FAR and (if applicable) CAS, and that the proposal is considered acceptable for negotiating a price. When minor inadequacies and insignificant noncompliances are noted, the above opinion statements may be varied to reflect the degree of qualification necessary for a clear

statement of the auditor's opinion.

E1.5.5.3.2.1. Adverse Opinion. An adverse opinion shall be expressed when there are denials of access to records/data having a significant effect on the audit, or when significant inadequacies or significant noncompliances are noted. The opinion will clearly describe or state (as applicable): the records denied, that the submitted data are not adequate, that the proposal was not prepared in accordance with the acquisition regulation and (when applicable) CAS, and that the proposal is, therefore, not acceptable as a basis for negotiation of a price.

E1.5.5.3.2.1.1. Prompt Notification. The conditions causing an adverse opinion shall be immediately reported to the contracting officer by oral notification as soon as noted. The notification shall be promptly confirmed by a narrative report explaining the need for the denied data/records and/or the nature of the deficiencies/inadequacies, and the general magnitude of cost impact on the proposal.

E1.5.5.3.2.1.2. Contradictive Wording. Only those conditions causing the adverse opinion shall be discussed in the narrative report. No other comments that would overshadow or contradict the adverse opinion shall be made, such as comments or cost exhibits reporting on the remainder of the proposal or a request for the contracting officer's negotiation memorandum.

E1.5.5.3.2.2. Disclaimer of Opinion. When the scope of the audit is restricted due to insufficient time to competently perform a review and an extension of time is denied, the auditor shall disclaim an opinion on the acceptability of the contractor's proposal as a basis for negotiating a price. The opinion shall state the amount and extent of costs not reviewed due to the time restriction. No other comments that would overshadow or contradict the disclaimer shall be made in an exhibit to the report for those elements of cost not audited. If the audit is to be continued after issuing the report this shall also be reported.

E1.6. MANAGEMENT OF AUDIT ORGANIZATION.

The head of the audit organization is responsible for properly managing the organization so that audit work fulfills the general purposes and responsibilities established by law or approved by the head or deputy head of the agency; resources of the audit organization are efficiently and effectively employed; and the audit work conforms to DoD auditing standards, policies, and procedures.

E1.6.1. Scope of Responsibility. Each audit organization shall maintain records of its universe that identify the contractor and related areas subject to its audit.

E1.6.2. Determination of Audit Priorities. Each audit organization shall periodically review its audit universe and determine the coverage, frequency, and priority of audit required for each. The review will include consideration of the following factors:

E1.6.2.1. Statutory and regulatory requirements.

E1.6.2.2. Adequacy of internal control systems as indicated by vulnerability assessments and internal control reviews.

E1.6.2.3. Newness, changed conditions, or sensitivity in contractors and their operations.

E1.6.2.4. Current and potential dollar magnitude and type of contract.

E1.6.2.5. Extent of Government participation in the contractor volume of business.

E1.6.2.6. Management needs to be met, including key management decision dates, as developed in consultation with the responsible procurement or contract administrative officials.

E1.6.2.7. Prior audit experience.

E1.6.2.8. Timeliness, reliability and scope of audits or technical evaluations performed by others.

E1.6.2.9. Availability of audit resources.

E1.6.3. Planning. Each audit organization should establish plans to carry out its responsibilities. The planning process involves establishing goals objectives, and audit plans, and assessing accomplishments.

E1.6.3.1. Long- and short-term goals and objectives should be established for the audit organization. The goals and objectives of the audit organization should be capable of being accomplished with specified operating plans and budgets and should be measurable. They should be accompanied by measurement criteria and

target dates for accomplishment.

E1.6.3.2. Each field audit office shall prepare an annual audit plan. The plan should be flexible and adjusted, as necessary, to provide for audit coverage of unforeseen priorities. The plan shall be reviewed upon completion at the next organizational level and ultimately the head of the agency. At a minimum, annual plans shall identify the contractors and dollars subject to audit by type of audit. For each major contractor, the plan shall include:

E1.6.3.2.1. Each contractor area requiring audit.

E1.6.3.2.2. Each audit area programmed.

E1.6.3.2.3. Staff hours required and programmed for each audit area.

E1.6.3.2.4. Basis for selection of audit areas programmed.

E1.6.3.2.5. Date an audit area was last reviewed.

E1.6.3.3. The annual programs shall be supported by audit area worksheets showing the objective for each area.

E1.6.3.4. The audit organization shall assess its results and accomplishments. It should have a sufficient data base from which to conduct such evaluations. That is, a history of past efforts and results to show prior performance, a planning process to show expected performance and a management information system to show actual performance and results. A realistic assessment of this collective information is essential to identify shortfalls in performance, to improve operations in the future, to determine whether goals and objectives are reasonable, and to affix accountability for results.

E1.6.4. Coordination. The audit organization shall coordinate its activities internally and with other components of Government to ensure effective use of available resources.

E1.6.4.1. In planning work to be performed, the audit organization shall coordinate with acquisition and contract administration officials to ensure that their needs are appropriately considered.

E1.6.4.2. The audit organization shall also take appropriate steps to minimize the undertaking of unnecessarily duplicative audit work. They should

coordinate their work with other DoD and Government audit organizations. The purpose of this coordination is to ascertain the nature and scope of other audits and reviews so as to prevent any duplicate effort.

E1.6.4.3. Audit plans shall be exchanged among DoD audit organizations. Also, the audit organization shall meet with the appropriate General Accounting Office officials to exchange and discuss tentative audit plans for the next fiscal year. If overlapping or duplicative coverage is indicated, every effort shall be made to resolve it.

E1.6.4.4. The audit staff shall be alert to situations where problems are identified that might affect other DoD Components of Federal agencies. When such situations arise, the audit organization shall coordinate with others involved so that, when appropriate, one audit may be performed to fulfill the requirements of all.

E1.6.5. Audit Organization Qualifications. The audit organization shall possess or obtain the knowledge, skills, and discipline needed to carry out its audit responsibilities.

E1.6.5.1. The audit staff shall collectively possess the knowledge and skills essential to the practice of the auditing profession. These attributes include proficiency in applying auditing standards, procedures, and techniques.

E1.6.5.2. The audit organization shall have employees or use consultants who are qualified in such disciplines as accounting, budgeting, statistical sampling, computer systems, engineering, law, or other specialty as needed to meet audit responsibilities. Each member of the audit organization, however, need not be qualified in all of these disciplines.

E1.6.6. Personnel Management and Development. The audit organization shall establish a program for selecting and developing its human resources. The program should provide for:

E1.6.6.1. Selecting qualified and competent individuals.

E1.6.6.2. Training and providing continuing educational opportunities for each staff member.

E1.6.6.3. Appraising each auditor's performance at least annually.

E1.6.6.4. Retaining and promoting highly skilled personnel to senior

management positions.

E1.6.6.5. Providing counsel to auditors on their performance and professional development.

E1.6.6.6. Rotating audit personnel on a periodic basis for developmental experience on the variety of contractors and assignments.

E1.6.7. Quality Assurance. Each audit organization shall establish and maintain a quality assurance program to ensure that work performed complies with DoD auditing standards, policies and procedures, internal regulations, and is carried out economically, efficiently, and effectively. A quality assurance program shall include supervision, internal reviews, and external reviews.

E1.6.7.1. Supervision of auditors shall be carried out continually to ensure conformance with auditing standards, organizational policies and procedures, and audit programs.

E1.6.7.2. Internal reviews shall be performed periodically by members of the audit staff to appraise the quality of the audit work performed. These reviews shall be performed in the same manner as an internal audit and documented by a written report.

E1.6.7.3. External reviews shall be performed to appraise the quality of the audit organization's operations. These reviews shall be performed by the Office of the Inspector General, DoD. On completion of the review, a formal written report shall be issued. The report shall express an opinion as to the organization's compliance with the DoD auditing standards and, as appropriate, shall include recommendations for improvement.