

Audit or Agreed-Upon Procedures?

*By Pete M. Gonzales, Jr., CPA, CFE
Financial Liaison Advisor (FLA)*

This article is a follow up to the information presented during the 311HSW/PK one-hour training class in December 2004 on the different advisory services that the Defense Contract Audit Agency (DCAA) offers. Again, the main focus is to know the difference between an “Audit” and “Agreed-Upon Procedures”. DCAA offers many different advisory services, among them are Audits and Agreed-Upon Procedures—what is the difference and how do you determine which is appropriate?

Because DCAA performs an array of audits and Agreed-Upon Procedures, it is sometimes difficult to know which type of advisory service is needed in a given circumstance. The following information is intended to provide an overview as well as a reinforcement of the differences between an “Audit” and an “Agreed-Upon Procedures”.

Before going any further, let’s review some terms:

Audit: It is an examination in which the highest level of assurance is provided. The objective of an audit is to gather sufficient evidence **to express an opinion** on the subject matter i.e. proposal, parts of proposal, financial capability review.

Agreed-Upon Procedures (AUP): The Auditor **does not** express an opinion verbally or in written form on the subject matter i.e. proposal, parts of proposal, financial capability review. **The procedures must be mutually agreed-to in advance with the requestor (customer).** They should be specific and subject to measurable criteria. The customer with DCAA’s assistance specifies the procedures to be accomplished. The report displays only findings based on specific procedures directed/requested by the customer.

Having a better understanding of the above terms, let’s ask when or under what circumstances each should be requested. Before contacting the auditor, it may be helpful to consider the following questions:

- Does the government have prior experience with the contractor and is it favorable or unfavorable?
- What is the dollar value of the proposal- is it significant?
- What is an acceptable level of risk?
- Is this a Cost type or Firm Fixed Price proposal?
- Does the contractor have an adequate accounting system, do significant deficiencies or system problems exist which may require additional audit coverage?
- How quickly is the information needed?

You as the requestor/customer are responsible for making the risk assessment. You should also know the time required to perform each of these advisory services.

Therefore, let's examine the time required to perform each service using **only proposals** as examples. It is DCAA's policy to perform, under normal circumstances, a full audit of an entire proposal in 30 days or less, and part of an audit or only specific parts of a proposal, under normal circumstances, in less than 3 weeks. An AUP can be performed in much less time because it is not necessary to perform many procedural steps, determine the risk assessment, or present an opinion. As a result, when compared to a full audit, an AUP should normally be received more quickly and with less cost to the government.

Regardless of whether you decide to request an AUP or an audit, it is essential that you and the auditor obtain a clear understanding of the detailed procedures being requested. The auditor will follow up in writing by issuing an acknowledgment letter detailing the specific procedural steps to which both parties have verbally agreed. **It should be noted that the auditor in adhering to Generally Accepted Government Auditing Standards, cannot agree to perform an AUP engagement if the requested procedures call for an audit opinion.**

To assist you and the auditor in the process of requesting an AUP, your request should:

1. Be specific,
 2. Clearly define terms with uncertain meaning (such as general review, limited review, check, or test).
 3. Avoid calling for opinion-like findings.
- Examples of opinion-like findings/words include:
- Perform a review of labor rates
 - Determine reasonableness of travel costs
 - Evaluate computer center savings
 - Test that proposal preparation costs are reasonable, allowable, and allocable, or
 - Verify indirect rates

Consider the following examples:

- Requesting information on Overhead Rates:
Inappropriate request for AUP: Verify the proposed O/H rate.
Appropriate AUP request: Calculate the actual 2003 O/H rate incurred using XYZ's books and records as of 12/31/2003, and then compare the resultant rate to the proposed O/H rate.
- Requesting information on Claimed Material Cost:
Inappropriate request for AUP: Review the claimed material items.
Appropriate AUP request: Select the five highest dollar proposed material items, and then compare the amount proposed to vendor invoices.

In both cases, the verbs "verify" and "review" have uncertain meanings, because the procedure is not specific and does not identify the criteria against which the overhead

rates and material costs are being verified. The procedures in an AUP engagement must be precisely defined in a way that leaves no room for any misunderstanding or any other reasonable interpretation.

Due to the limiting aspects of a properly stated AUP request, an AUP engagement is not suitable for all situations, but an AUP can be an effective utilization of both Government resources in circumstances when a complete audit is not required.

Determining which of the DCAA's advisory services to request need not be difficult. Remember to consider the type and size of the contract and any specific requirements it contains as well as the historical performance and financial and record keeping capability of the contractor or subcontractor. Finally, should you have insufficient trust in the contractor's data or credibility; an **audit** should be requested regardless of the time available. When in doubt be sure to discuss it with the auditor or your FLA.

BIO-Mr. Gonzales has a Bachelor's degree in Accounting/Finance from the University of Texas at San Antonio and a Master's in Science of Administration (MSA) from Central Michigan University. He is a Certified Public Accountant (CPA) and a Certified Fraud Examiner (CFE).