

DCAA MEMORANDUM FOR REGIONAL DIRECTORS COVER SHEETAUDIT GUIDANCE/AUDIT MANAGEMENT GUIDANCE MEMORANDUM NO. 09-PAS-014(R)Date of MRD: July 23, 2009

Subject of MRD: Audit Guidance on Federal Acquisition Regulation (FAR) Revisions Related to Contractors' Code of Business Ethics and Conduct

Current Audit Guidance and/or Audit Management Guidance Affected:**CAM****Paragraph Explanation of Effect on Current Version of CAM**5-306, 5-311.3, and 5-907g Made necessary changes to CAM sections to address the new FAR provisions.**AUDIT PROGRAMS**

5 Digit Activity Code	Subactivity/Document Name	Step No.	Explanation of Effect on Current Audit Program
<u>11070</u>	<u>Control Environment and Overall Accounting System Controls</u>	<u>C-1</u>	<u>Updated references to the new FAR provisions and changed steps to ensure the new FAR requirements are adequately addressed.</u>

SHELL AUDIT REPORTS

5 Digit Activity Code	Subactivity/Document Name	Sec./Par.	Explanation of Effect on Current Audit Report
<u>NONE</u>			

MEMORANDUMS FOR REGIONAL DIRECTORS

MRD No.	Date	Subject/Explanation of Change
<u>NONE</u>		

INTERNAL CONTROL QUESTIONNAIRE/INTERNAL CONTROL MATRIX/INTERNAL CONTROL AUDIT PLANNING SUMMARY

ICQ/ICM/ICAPS	Section & No.	State Control(s) Affected by the Change
<u>ICM</u>	<u>11070</u>	<u>Updated references to the new FAR provisions and changed steps to ensure the new FAR requirements are adequately addressed.</u>

DCAA PAMPHLETS/REGULATIONS/INSTRUCTIONS

DCAAP/R/I/No.	Date	Page/Sec./Par.	Explanation of Effect
<u>NONE</u>			



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAS 730.3.B.2

July 23, 2009
09-PAS-014(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Guidance on Federal Acquisition Regulation (FAR) Revisions Related to
Contractor Code of Business Ethics and Conduct

Summary

Auditors should incorporate the revised procedures discussed in this guidance in any in-process Control Environment and Overall Accounting System Control audits (activity code 11070).

This memorandum is being issued to revise our audit guidance for reviewing the contractor's control environment during our Control Environment and Overall Accounting System Control audits. The guidance is being expanded due to the changes to the Federal Acquisition Regulation (FAR) which was revised to require contractors to have (1) a written code of business ethics and conduct, (2) a business ethics and compliance training program, and (3) an internal control system that facilitates timely discovery and disclosure of improper conduct, and ensures corrective measures are promptly instituted and carried out. We have updated the Control Environment and Overall Accounting System Control audit program (activity code 11070) (Enclosure 2) and CAM (Enclosure 3) to revise the audit procedures to incorporate the new provisions. The audit program is being provided in "track changes" format so that auditors can easily identify the changes made based on this guidance. Additionally, in the beginning of August, we will be issuing a presentation to be used by FAO(s) to communicate this guidance during FAO staff and PWT meetings. By September 15, 2009, we will also be issuing guidance regarding the audit effort to be performed related to nonmajor contractors to be implemented in FY 2010.

Background

A final rule (FAR Case 2006-007) was published on November 23, 2007 and became effective December 24, 2007. The final rule added FAR Subpart 3.10, Contractor Code of Business Ethics and Conduct, and contract clauses at FAR 52.203-13, Contractor Code of Business Ethics and Conduct, and FAR 52.203-14, Display of Hotline Poster(s). These rules include requirements that were formerly in the DFARS regarding contractor code of business ethics, internal controls, and display of hotline posters. Since these FAR changes incorporate

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and expand upon the requirements previously in DFARS 203.70, Contractor Standards of Conduct, the DFARS section was deleted as of August 12, 2008.

A second final rule (FAR Case 2007-006) was published on November 12, 2008 and became effective December 12, 2008. The final rule revised the new FAR Subpart 3.10 and the applicable contract clause FAR 52.203-13. This rule added requirements for disclosure of violations of criminal laws, the civil False Claims Act, significant overpayments, and consequences for failure to disclose. FAR 3.1003 was revised to state that (1) contractors may be suspended and/or debarred for knowing failure to submit timely disclosure to the Government of a violation of federal criminal law (FAR 3.1003(a)(2)) and (2) if the contractor becomes aware that the Government has overpaid, the contractor shall remit the overpayment amount to the Government. A contractor may be suspended and/or debarred for knowing failure to timely disclose credible evidence of a significant overpayment (FAR 3.1003(a)(3)).

A summary of the more significant requirements of FAR 52.203-13 and FAR 52.204-14 are contained in Enclosure 1. FAR 52.203-13 is applicable for all contracts and subcontracts in excess of \$5 million with a performance period of 120 days or more. The applicability of FAR 52.204-14 is contained in FAR 3.1004(b)(1).

Guidance

During audits of the contractor's Control Environment and Overall Accounting System Controls, auditors should perform procedures to address the requirements in FAR 52.203-13, Contractor Code of Business Ethics and FAR 52.204-14, Display of Hotline Poster. We have revised the audit program (activity code 11070) to include those procedures. Auditors should incorporate these revised procedures in any in-process Control Environment and Overall Accounting System Control audits (activity code 11070).

The new FAR provisions include policies and procedures related to contractor code of business ethics and conduct. The provisions require Government contractors to conduct themselves with the highest degree of integrity and honesty. In addition, contractors should have a written code of business ethics and conduct, an employee business ethics and compliance training program, and an internal control system that:

- are suitable to the size of the company and extent of involvement in Government contracting;
- facilitate timely discovery and disclosure of improper conduct with Government contracts; and
- ensure corrective measures are promptly instituted and carried out.

One of the more significant provisions requires contractors to disclose certain types of serious wrongdoing in writing to the agency Office of the Inspector General (OIG), with a copy to the contracting officer, whenever the contractor has credible evidence of such activity by a principal, employee, agent, or subcontractor (FAR 52.203-13(c)(2)(ii)(F)). In addition,

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the FAR revisions provide for possible suspension and/or debarment for knowing failure to timely disclose such violations. A contractor's failure to promptly report such wrongdoing should be reported as an internal control deficiency. In addition, if deficiencies are identified related to the requirements in FAR 52.203-13(c)(2)(ii)(F), the DCAA Justice Liaison Auditor (DCAAHQJLA@dcaa.mil) will be included on the distribution for the audit report.

In addition to revising the Control Environment and Overall Accounting System Control audit program we have revised CAM 5-306, Integrity and Ethical Values (Enclosure 3). In the beginning of August, we will be issuing a presentation to be used by FAO(s) to communicate this guidance during FAO staff and PWT meetings. By September 15, 2009, we will also be issuing guidance regarding the audit effort to be performed related to nonmajor contractors to be implemented in FY 2010.

FAO personnel should direct questions to their regional points of contact and regional personnel should direct any questions to Jennifer Quinones, Program Manager, Auditing Standards Division, at (703) 767-3274, or by email: PAS@dcaa.mil.

/s/
Kenneth J. Saccoccia
Assistant Director
Policy and Plans

Enclosures: 3
a/s

DISTRIBUTION: C

Significant FAR Requirements
FAR 52.203-13, Contractor Code of Business Ethics and Conduct
and FAR 52.204-14, Display of Hotline Poster

Code of Business Ethics and Conduct (FAR 52.203-13(b)(1)(i))

- Requires contractors to have a written code of business ethics and conduct, and make a copy of the code available to each employee engaged in the performance of the contract.

Training (FAR 52.203-13(c)(1))

- Requires an ongoing business ethics and compliance program, including conducting effective training programs on the contractor's standards and internal control system. The training shall be provided to the contractor's principals and employees, and as appropriate, the contractor's agents and subcontractors.

Periodic Reviews (FAR 52.203-13(c)(2)(ii)(C))

- Contains specific requirements for companies to perform periodic reviews of company business practices, procedures, policies and internal controls, including:
 - monitoring and auditing to detect criminal conduct;
 - periodic evaluation of the effectiveness of the business ethics awareness and compliance program and internal control system (especially if criminal conduct has been detected); and
 - periodic assessment of the risk of criminal conduct, with appropriate steps to design, implement, or modify the business ethics awareness and compliance program and the internal control system as necessary to reduce the risk of criminal conduct identified through this process.

Internal Reporting Mechanism (FAR 52.203-13(c)(2)(ii)(D))

- Requires the contractor's internal control system to provide for an internal reporting mechanism, such as a hotline, which allows for anonymity or confidentiality, by which employees may report suspected instances of improper conduct, and instructions for employees to make such reports.

Disciplinary Action (FAR 52.203-13(c)(2)(ii)(E))

- Requires the contractor's internal control system to provide for disciplinary action for improper conduct or for failing to take reasonable steps to prevent or detect improper conduct.

Significant FAR Requirements
FAR 52.203-13, Contractor Code of Business Ethics and Conduct
and FAR 52.204-14, Display of Hotline Poster

Disclosure of Improper Conduct (FAR 52.203-13(c)(2)(ii)(F))

- Provides detailed requirements for making timely disclosure of improper conduct. This provision requires contractors to disclose, in writing, to the agency Office of the Inspector General, with a copy to the contracting officer, whenever the contractor has credible evidence that a principal, employee, agent, or subcontractor has violated Federal criminal law involving fraud, conflict of interest, bribery, or violations with the gratuities regulations or the False Claims Act (FAR 52.203-13(c)(2)(ii)(F)).

Full Cooperation

- Requires full cooperation with any Government agencies responsible for audits, investigations, or corrective actions (FAR 52.203-13(c)(2)(ii)(G)).
- Defines full cooperation as “...disclosure to the Government of the information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes providing timely and complete responses to Government auditors’ and investigators’ request for documents and access to employees with information” (FAR 52.203-13(a)).

Display of Hotline Posters (FAR 52.203-14)

- Requires, for contracts performed in the United States, display of:
 - Department of Homeland Security fraud hotline poster(s) identified by the contracting officer in the contract clause at FAR 52.203-14;
 - agency hotline poster (unless the contractor has implemented a business ethics and conduct awareness program, including a reporting mechanism); and
 - the hotline poster(s) on the company website for employees (if a website is maintained).

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Activity Code 11070	Control Environment and Overall Accounting System Controls
Version 7.06.3 , dated July 2009	
B-1	Planning Considerations
Purpose and Scope	
The major objectives of this audit are to:	
<ul style="list-style-type: none"> • Evaluate the adequacy of and the contractor’s compliance with the accounting system internal controls. 	
<ul style="list-style-type: none"> • Obtain a sufficient understanding of the contractor’s control environment and overall accounting controls (including both manual and computerized activities) to plan related audit effort. This requires that the auditor assess the adequacy of the contractor’s accounting policies and procedures, whether they have been implemented, and if they are working and being monitored effectively. 	
<ul style="list-style-type: none"> • Document the understanding of the control environment and the overall accounting controls in working papers and permanent files. 	
<ul style="list-style-type: none"> • Assess control risk as a basis to identify factors relevant to the design of substantive tests. 	
<ul style="list-style-type: none"> • Report on the understanding of the accounting system internal control, assessment of control risk, and the adequacy of the system for performing on Government contracts. 	
<p>This audit is limited to the examination of the control environment and the overall accounting controls for major contractors, nonmajor contractors where the system is considered significant, and contractors with substantial firm fixed price contracts. Only those controls directly related to the contractor’s overall accounting system, as defined below, will be audited under this assignment. Controls for interrelated audit concerns regarding the adequacy of the contractor’s major accounting subsystems (i.e., labor, MMAS, indirect & ODC, etc.) will be audited under separate assignments. While the controls for these areas are not part of this audit, the results of all audits of these interrelated controls must be considered in forming an overall audit conclusion of the overall accounting system. The results of this audit should also be commented on in reports on related audit areas.</p>	
<p>When performing an update or follow-up examination, the steps should be adjusted and tailored accordingly. To the extent possible, prior audit effort should be used as a basis for validating the contractor’s internal control.</p>	
<p>Before beginning this examination, the auditor should inquire about internal control evaluations performed by the contractor or its external auditors relating to this audit area. In those cases where internal or external evaluations have been performed, the auditor should follow guidance contained in CAM 4-1000, Relying Upon the Work of Others.</p>	

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<p>Before performing any examination of internal controls, the auditor should determine that the system contemplated for examination is material to the Government. Once it is determined that the system is material to the Government, the auditor should reassess the materiality of each section in the internal control audit before performing any audit steps in that section. The scope of any audit depends on individual circumstances. The auditor is expected to exercise professional judgment, considering vulnerability and materiality, in deciding the scope of audit to be performed.</p>
<p>The use of computers of all kinds in a contractor’s accounting and management systems is so pervasive it is unlikely that any audit of them could be performed adequately without an examination of the internal controls over their automated aspects. Therefore, the auditor should become familiar with guidance contained in the Information Systems (IS) Auditing Knowledge Base that is contained on DCAA’s Intranet, and CAM 5-1400, Audit of Information Technology Systems Application Internal Controls, prior to the beginning of this audit. In addition, in some instances, the assistance of IT specialists may be required to adequately evaluate the automated aspects of the internal controls. In these cases, auditors should coordinate, through their supervisory auditor, to contact their regional office to obtain the necessary expertise.</p>
<p>The internal control matrix (see Internal Control Matrix – Control Environment and Overall Accounting Controls) showing the interrelationships among the control objectives, example control activities, and audit procedures used in this audit program. The control objectives and the audit procedures have been fully integrated into this audit; therefore, the matrix is not needed unless it is desirable to see the associated example control activities and the interrelationships in a matrix format.</p>
<p>In cases where this examination covers internal control systems at multi-segment contractors, follow the guidance in CAM 5-103.2 and 5-110e. Auditing internal controls at multi-segment contractors requires effective coordination among cognizant auditors to identify the audit responsibilities at each location to ensure appropriate audit coverage when contractor locations share components of an internal control system, such as policies and procedures, common technologies (e.g., software) or common management. FAOs cognizant of segment locations should initiate assist audits from off-site locations as necessary. FAOs cognizant of off-site locations should not self-initiate audits of internal controls.</p>
References
CAM 3-300, Internal Control Audit Planning Summary (ICAPS)
CAM 5-100, Obtaining an Understanding of a Contractor’s Internal Controls and Assessing Control Risk
CAM 5-300, Audit of Internal Controls – Control Environment and Overall Accounting Controls
CAM 5-1400, Audit of Information Technology Systems Application Internal Controls
CAM 10-400, Audit Reports on Operations and Internal Control (System Audits)

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B-1	Preliminary Steps	W/P Reference
	Version 7.0, dated July 2009	
	1. Research and Planning	
	a. Become familiar with applicable sections of CAM 5-300. Any recent relevant Headquarters guidance (i.e., MRDs, AGMs, and AMGMs) not incorporated in the CAM can be accessed from the Agency-Wide Library available on the DCAA’s intranet home page.	
	b. Perform the following steps using the permanent file:	
	(1) Review prior accounting system audit working paper package.	
	(2) Identify any accounting system deficiency reports issued (review ICRS database, as applicable). Document the results of (1) and (2) on W/P B-2.	
	(3) Determine if there are any reported deficiencies in the other internal control system audits that impact the scope of this accounting system audit (review ICRS database, as applicable). Document on W/P B-2. The results of the IT Systems General Internal Controls examination, if any, should also be evaluated and documented in detail under Information and Communications, Section E-1, Step 1.	
	(4) Identify the sources for the detailed policies, procedures, charts, etc., called for in steps (a) through (d) below. Document the sources of data by listing the data, its source, and any changes since the last system audit.	
	(a) Contractor’s written policies and procedures and accounting system manual.	
	(b) Organization charts depicting the functional areas responsible for developing and processing accounting related data.	
	(c) Accounting system flowcharts providing a pictorial overview of all manual and computerized processing steps (including interfaces between the general accounting system and other systems).	
	(d) Information systems documentation:	
	(i) Pertinent record layouts of files created and/or used during the processing of accounting system related transactions.	
	(ii) Database table definitions.	
	(iii) Source documents.	

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(iv) Information on the conversion of documents to computer media.	
(v) Subsidiary or master files affected by the system.	
(vi) Relevant reports, journals, and ledgers produced in the flow of information to the accounting system reports.	
(5) Review audit lead sheets.	
(6) Review other related audits, for example the impact of suspected irregular conduct (SIC) and CAS noncompliances, if applicable.	
(7) Consider the impact of the contractor’s financial condition on the accounting system. (Refer to prior financial capability assessments or audits – 176XX).	
c. Discuss the planned evaluation of the Control Environment and the Overall Accounting Controls with the administrative contracting officer and the contractor’s major procuring activities to identify, understand, and document any concerns they may have of areas which should be evaluated.	
<p>d. In planning and performing the examination, consider the fraud risk indicators specific to the audit. The principal sources for the applicable fraud risk indicators are:</p> <ul style="list-style-type: none"> • Handbook on Fraud Indicators for Contract Auditors, Section II (IGDH 7600.3, APO March 31, 1993) located at www.dodig.osd.mil/PUBS/index.html, and http://www.dodig.mil/PUBS/igdh7600.doc <p><u>(To access the handbook, copy and paste the web address shown above into the address block in Internet Explorer.)</u></p> <ul style="list-style-type: none"> • CAM Figure 4-7-3. <p>Document in working paper B any identified fraud risk indicators and your response/actions to the identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.</p>	
e. Obtain from the contractor a schedule of total dollars processed through the accounting system for the past twelve months (or most recently completed fiscal year) and summarize by total dollars and dollars by Government flexibly priced contracts and fixed price contracts in order to determine the materiality of the accounting system. Complete the Materiality section of the ICAPS form at W/P A.	
f. FAOs that have cognizance of contractors with significant classified contracts should coordinate with the Field Detachment to determine the DCAA office responsible for reviewing costs on classified contracts.	

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<p>This coordination should be documented in the working papers. FAOs should also coordinate with the Field Detachment on any significant accounting system issues.</p>	
<p>g. Close coordination is required at FAOs cognizant of a shared services location and the FAOs cognizant of the segments serviced by the shared services. Document the objectives and procedures to be performed at the shared services location and the segment level. Request assist audits, as applicable.</p>	
<p>h. Determine the extent and results of the contractor’s self-governance activities, internal and external audits, and coordinated audits related to the accounting system.</p>	
<p>(1) Request the contractor provide a list of completed internal and external audits and determine if any are related to the accounting system.</p>	
<p>(2) If applicable, coordinate with the CAC or corporate office auditors to determine if any internal control weaknesses that might impact the accounting system were identified in management’s internal control report or the independent auditor’s attestation on management’s assertion included in the annual report filed with the SEC.</p>	
<p>(3) In those cases where internal or external audits have been performed, the auditor should follow the guidance contained in CAM 4-1000, Relying Upon the Work of Others. Document your preliminary evaluation and its impact on the scope of this examination. The evaluation of internal audit working papers is documented in detail under Monitoring in Section F 1, step 3.</p>	
<p>i. Determine the need for technical assistance, if any, and document your consideration on working paper B-3.</p>	
<p>2. Entrance Conference and Preparation</p>	
<p>a. Prepare a written memorandum to the contractor to arrange for an entrance conference, covering the areas highlighted in CAM 4-302 and any specific data or pertinent information not yet provided.</p>	
<p>b. Conduct an entrance conference as outlined in CAM 4-302, with particular emphasis on:</p>	
<p>(1) Requesting the contractor to provide, if applicable, a system orientation briefing or a demonstration of the overall accounting system transaction flow including data input, data processing, data output, and related internal controls. Document under Information</p>	

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and Communications, Section E-1, Step 3.	
(2) Determining any changes in the accounting system process since the last examination.	
(3) Discussing the contractor's risk assessment process. Overall understanding of contractor's processes will be documented under Contractor Risk Assessment, Section D-1.	
(4) Discussing the contractor's monitoring process to ensure that established manual and computerized controls are functioning as intended. Document under Monitoring, Section F-1.	
(5) Discussing any identified weaknesses which may have been previously reported and related follow-up actions taken.	
3. Other Preliminary Steps	
a. Determine the degree a computerized system is used in the accounting process.	
b. Perform a high level cursory assessment to determine if the following exist:	
(1)a. A functional accounting organization with defined organizational responsibilities.	
(2)b. A written description of the work flow in the accounting process.	
(3)c. Policies and procedures for effectively controlling the process.	
4. Initial Risk Assessment	
Using the information obtained in steps 1, 2, and 3, prepare an initial risk assessment (W/P B) to determine the scope of the examination.	

C-1	Control Environment	W/P Reference
Version 7.0, dated July 2009		
The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. The auditor should obtain a sufficient understanding of the control environment to determine the impact that it may have on the overall		

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<p>effectiveness of the contractor’s system of internal controls. (See Internal Control Matrix – Control Environment and Overall Accounting Controls, working paper 31.) The auditor should recognize those aspects of the contractor’s Control Environment and Overall Accounting Controls (either automated or manual) and should ensure that the related control activities adequately address those processes by performing the audit procedures set forth below.</p>	
<p>1. Integrity and Ethical Values</p>	
<p>Management must convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message through continuous demonstration of words, actions, and commitment to high ethical standards.</p>	
<p>a. <u>Contractor Code of Business Ethics and Conduct - Evaluate contractor policies, procedures, training, and compliance with policies and procedures related to conveying integrity and ethical values. Compliance with DFARS 203.70, Contractor Standards of Conduct, should be considered for DoD contractors. Perform procedures to address the requirements in FAR 52.203-13, Contractor Code of Business Ethics and Conduct.</u></p>	
<p>(1) <u>Verify the existence of a written codes of conduct and review the contents to ensure it addresses ethical business practices, conflicts of interest, and expected standards of ethical and moral behavior. The code should cover dealings with customers, suppliers, employees, and other parties (See CAM 5-306.1). Selectively test the codes of conduct to determine if they adequately cover expected standards of conduct that affect significant internal and external business and employee relationships (DFARS 203.7001(a)(1)).(FAR 52.203-13(b)(1)).</u></p>	
<p>(2) <u>Ethics Training Program. Verify that the contractor’s policies and procedures provide for an ethics training program for all employees. Selectively test this control by evaluating completed training records (DFARS 203.7001(a)(1)).Obtain evidence that the code of conduct was made available to each employee (FAR 52.203-13(b)(1)).</u></p>	
<p>(3) Verify that written codes of conduct (a) are periodically communicated to all employees, (b) are formally acknowledged, and (c) cite consequences for violations.</p>	
<p>(4)Verify that the contractor performs periodic reviews of company business practices, procedures, and internal controls</p>	

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<p>for compliance with standards of conduct (DFARS 203.7001(a)(2)).</p>	
<p>b. <u>Business Ethics Awareness and Compliance Program - Evaluate contractor self governance activities, as well as the reporting to and cooperation with the Government. Compliance with DFARS 203.70, Contractor Standards of Conduct, should be considered for DoD contractors. Perform procedures to address the requirements in FAR 52.203-13, Contractor Code of Business Ethics and Conduct, and FAR 52.203-14, Display of Hotline Poster(s).</u></p>	
<p>(1) <u>Verify that the contractor’s policies and procedures provide for a business ethics awareness and compliance program (FAR 52.203-13(c)(1).</u></p>	
<p>(2) <u>Verify that the business ethics awareness and compliance program includes an ethics training program for all principals and employees, and as appropriate, the contractor’s agents and subcontractors. Selectively test this control by evaluating training program materials and training records of completion (FAR 52.203-13(c)(1). The training program should cover the contractor’s code of business ethics and conduct (see CAM 5-306.1).</u></p>	
<p>(3) <u>Verify that the manager responsible for the ethics program reports to a high level official (e.g., vice president/CFO).</u></p>	
<p>(4) <u>Contractors should not appoint, as a principal (e.g., officer, director, partner), an individual who previously engaged in conduct that conflicts with the contractor’s code of conduct (FAR 52.203-13(c)(2)(ii)(B)). Auditors should review the contractor’s policies and procedures and test the procedures to verify that they include steps for exercising due diligence in identifying such conduct (e.g., require background checks before appointing principals of the company) and that the steps have been taken when applicable.</u></p>	
<p>(5) <u>Verify that the contractor performs periodic reviews (i.e., at least annually) of company business practices, procedures, and internal controls for compliance with the contractor’s code of business ethics and conduct and special requirements of Government contracting, including the specific requirements in FAR 52.203-13(c)(2)(ii)(C). Review the results of the recent reviews and assess any impact on this audit.</u></p>	
<p>(4)(6) <u>Verify that the contractor has an internal reporting system to identify/report noncompliances with codes of conduct and pursues corrective actions. Contractors should have a mechanism, such as a hotline, which allows for anonymity or confidentiality, by which employees may report suspected</u></p>	

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<p><u>instances of improper conduct, and instructions that encourage employees to make such reports (DFARS 203.7001(a)(3)) FAR 52.203-13(c)(2)(ii)(D)).</u></p>	
<p>(2)(7) <u>Determine the extent to which the contractor participates in self-governance programs, such as Coordinated Audit Planning, Defense Industry Initiative, DoD Hotlines, or any procedure for reporting suspected irregularities. Verify that the contractor’s policies and procedures provide for appropriate disciplinary action for improper conduct, or failing to take reasonable steps to prevent or detect improper conduct (FAR 52.203-13(c)(2)(ii)(E)). Review the contractor’s assessment of whether disciplinary action was needed related to the incidences of improper conduct, and the action that was taken (if applicable) and ascertain if reasonable (see CAM 5-306.3).</u></p>	
<p>(3)(8) <u>Reporting to Government Officials.—Verify that the contractor’s policies and procedures provide for timely reporting/disclosure to the agency OIG, with a copy to the contracting officer, appropriate Government officials of any suspected when there is credible evidence of a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity, or a violation of the civil False Claims Act in connection with Government contracts or any other irregularities in connection with such contracts (DFARS 203.7001(a)(6)) (see CAM 5-306.3) (FAR 52.203-13(c)(2)(ii)(F)). Request a copy of any disclosures made and verify that the contractor complied with their policies and procedures. If deficiencies are identified related to the requirements in FAR 52.203-13(c)(2)(ii)(F), the DCAA Justice Liaison Auditor (DCAAHQJLA@dcaa.mil) will be included on the distribution for the audit report.-</u></p>	
<p>(9) <u>Review any disclosures obtained in step 8 above. Ascertain if the contractor has taken the necessary corrective actions to protect the Government’s interests. If the contractor has not taken the appropriate corrective action, the auditor should report this as an internal control deficiency.</u></p>	
<p>(4)(10) <u>Verify that the contractor’s policies and procedures provide for cooperation with any Government agencies responsible for audits, an investigations, or corrective actions involving any suspected violation of law (DFARS 203.7001(a)(7)) (FAR 52.203-13(c)(92)(ii)(G)). Confirm that there are no outstanding access to records issues or subpoenas that may indicate a lack of cooperation.</u></p>	
<p>(5)(11) <u>If a DoD contractor does not have an adequate system of management controls implementing the standards of conduct,</u></p>	

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<p>verify that the contractor has displayed the DoD Hotline Poster prepared by the DoD Office of the Inspector General. (DFARS 203.7001(b)) Verify that the contractor includes the substance of FAR 52.203-13 and 52.203-14, when appropriate, in its subcontracts (FAR 52.203-13(d)(1) and FAR 52.203-14(d)). Review a sample of subcontracts that should contain the clause to determine if the FAR clauses are included in the subcontracts.</p>	
<p>e. Evaluate management intervention and/or overrides.</p>	
<p>(1) Determine whether policies and procedures address the situations and frequency of management intervention, require documentation and approval of intervention, and the strict prohibition of any management overrides.</p>	
<p>(2) If applicable, selectively evaluate documentation of management interventions or overrides. Assess compliance with policies and procedures.</p>	
<p>d. Evaluate internal and external audit functions and efforts related to the current accounting system.</p>	
<p>(1) Determine whether the contractor's system of management controls provides for internal and/or external audits (DFARS 203.7001(a)(4)).</p>	
<p>(2) If the internal or external auditor's work will be relied upon, follow the guidance in CAM 4-1004 to evaluate and document:</p> <p>(a) the competency, independence, and objectivity of the internal/external auditor (place a copy of this effort in the permanent file), and</p> <p>(b) the overall quality and applicability (usefulness in reducing the scope of our own evaluation) of the internal/external auditor's work.</p> <p>If reliance is not to be placed on either of these audit functions, document the reasons why and consider this in your overall assessment of this control objective.</p>	
<p>(3) Determine whether the contractor has an adequate audit plan for conducting internal control and compliance reviews.</p>	
<p>(4) Verify that there are effective follow-up procedures on internal audit recommendations.</p>	
<p>(5) Obtain the external CPA's report of material weaknesses of internal controls and/or management letter for the most recently audited year.</p> <p>(a) For identified weaknesses of internal control, determine that</p>	

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<p>corrective action has been taken to correct the item(s).</p> <p>(b) Verify that the external CPA does not provide accounting services to the contractor.</p>	
<p>(6) If applicable, review the annual report for SEC registrants for an internal control report. This report includes an assessment of the effectiveness of the internal control structure and procedures for financial reporting, and the independent auditor must attest to and report on the contractor's assessment.</p> <p>(a) Auditors located at segments or divisions of SEC Registrant companies will need to coordinate this effort with the CAC or Corporate auditors.</p> <p>(b) Determine whether corrective action has been taken in response to internal control weaknesses.</p>	
<p>(7) Determine the reason for any recent changes in external auditors. Review the associated SEC filing by predecessor auditors for corroborating evidence.</p>	
<p>e. Identify any access to records problems which impact our ability to assess the internal control.</p>	
<p>f. Identify potential internal control weaknesses inherent in any Form 2000 or ongoing investigation.</p>	
<p>2. Board of Directors/Audit Committee <u>External Auditor's Report</u></p>	
<p><u>a. Obtain the external CPA's report of material weaknesses of internal controls and/or management letter for the most recently audited year. For identified weaknesses of internal control, determine that corrective action has been taken to correct the item(s).</u></p>	
<p><u>b. Review the annual report for SEC registrants for an internal control report. This report includes an assessment of the effectiveness of the internal control structure and procedures for financial reporting, and the individual auditor must attest to and report on the contractor's assessment.</u></p>	
<p><u>(1) Auditors located at segments or divisions of SEC Registrant companies will need to coordinate this effort with the CAC or Corporate auditors.</u></p>	
<p><u>(2) Determine whether corrective action has been taken in response to internal control weaknesses.</u></p>	
<p><u>c. Determine the reason for any recent changes in external auditors.</u></p>	

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<p><u>Review the associated SEC filing by predecessor auditors for corroborating evidence.</u></p>	
<p><u>3. Board of Directors/Audit Committee</u></p>	
<p>The Board of Directors and the Audit Committee should be sufficiently independent from management to constructively challenge managements’ decisions and act effectively on external audit communications and recommendations. The Board and Audit Committee should take an active role to ensure an appropriate upper managements’ commitment to ethical business practices and behavior. Auditors at contractor segments should request assist audits from the auditor cognizant of the corporate office to accomplish the applicable audit steps below.</p>	
<p>a-a. Obtain a list of Board of Director and Audit Committee members. Determine their relationship to the business and assess their independence.</p>	
<p>b-b. Evaluate the minutes of the Board of Directors' meeting and all communications with the Audit Committee or body of similar authority to determine if the Board is taking an active role in significant management decisions.</p>	
<p>e-c. Evaluate the minutes of the Audit Committee meetings to determine if the committee (and/or Board of Directors) is acting effectively on all audit matters, including internal and external audit recommendations.</p>	
<p>d. Verify that the internal audit department is functionally and organizationally independent to achieve objectivity in the conduct of its audits.</p>	
<p><u>3.4. Basic Structural Organization</u></p>	
<p>The organizational structure provides the overall framework for planning, directing, and controlling operations. This structure defines the form and nature of the organization, as well as the management functions and reporting relationships. Authority and areas of responsibility should be appropriately assigned.</p>	
<p>a. Complete or update the contractor's basic organizational structure questionnaire. (See Survey of Contractor’s Organization in “Other Audit Guidance” folder.)</p>	

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b. Review the current organization chart to determine whether it delineates clear lines of authority.	
4.5. Assignment of Authority and Responsibility	
Management ensures that appropriate responsibility and delegation of authority is assigned to deal with goals and objectives, operating functions, regulatory requirements, information systems, and authorization for changes. The delegation of authority ensures a basis for accountability and control and sets forth individual respective roles.	
a. Verify that policies and procedures exist which specifically state the limitation or delegation of authority	
b. Verify that there is a clear assignment of responsibility and delegation of authority to deal with such matters as goals, objectives, operating functions, and regulatory requirements.	
5.6. Financial Capability	
Management must ensure the contractor has adequate financial resources to perform on Government contracts.	
a. Verify that management regularly conducts financial analyses and monitors contract cost performance. Observe that procedures are in place and appropriate management and the Board of Directors is being informed of adverse conditions.	
b. Evaluate notes to financial statements, management certifications, and SEC filings (including Management Discussion & Analysis) for any indication of potential adverse financial conditions and discuss these conditions with the controller or other financial managers.	
c. Consider the impact of any off-balance sheet arrangements disclosed (CAM 14-306).	
d. Consider the impact of severe financial distress on the ability of the contractor to perform on Government contracts.	
e. Determine that policies and procedures require the preparation of an accounts payable aging schedule and that results are elevated to appropriate levels of management.	
f. Evaluate procedures for analyzing the collectibility of receivables.	

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g. Evaluate procedures and verify that the contractor monitors loan covenants and sets up payment schedules.	
h. Verify that the contractor periodically prepares and evaluates cash flow projections.	

D-1	Contractor Risk Assessment	W/P Reference
Version 7.0, dated July 2009		
The auditor should develop a sufficient understanding of the risk assessment process currently employed by the contractor in terms of its identification, analysis, and management of risks relevant to the accumulation and recording of contract cost data.		
1. Meet with responsible personnel to obtain an overview of the various risk factors considered by management.		
2. Once the various risk factors are identified, obtain an understanding of how management identifies the risks, estimates the significance of risks, assesses the likelihood of their occurrence, and relates them to contract reporting.		
3. If applicable, obtain an overview of any plans, programs, or actions management may initiate to address specific risks. Keep in mind that, depending on the nature of specific risks, management may elect to accept a given risk due to costs or other considerations.		
4. Document your overall understanding of the contractor’s risk assessment practices and the impact that it has on the nature and extent of testing of each control objective (W/Ps G and H).		

E-1	Information and Communications	W/P Reference
Version 7.0, dated July 2009		
Information and communication processes consist of the methods and records established to record, process, summarize, and report contract cost data. The auditor should develop a sufficient understanding of the contractor’s information and communication processes (relevant to contract cost data) to identify significant classes of transactions and how they are initiated, processed, controlled, and reported.		
1. Since the information system is an integral component of information and communication processes, evaluate the most recently completed ICAPS for the IT System General Internal Controls for the rationale behind any moderate or high-risk assessment ratings and determine the		

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<p>potential impact, if any, on the effectiveness of the contractor’s overall accounting system internal controls on information and communications. A necessary step in understanding the information and communication process is to trace selected transactions through the system (see Step 5 below). This will assist in validating the contractor’s demonstration of the system and identifying key controls requiring subsequent testing.</p>	
<p>2. Evaluate relevant permanent files, prior audit working papers, and any prior contractor demonstrations of its overall accounting system information and communication processes.</p>	
<p>3. Determine if the contractor has made changes to the information and communication processes in its accounting system since the last demonstration. Evaluate the changes. If no prior systems demonstration was performed, have the contractor provide one. Contractor representatives providing the demonstration should possess a detailed knowledge of the accounting system. The demonstration provides the auditor an opportunity to query contractor personnel regarding internal controls and how they are monitored. The auditor should ensure that the demonstration addresses the internal control objectives outlined in CAM 5-300.</p>	
<p>4. The contractor should include appropriate manual and computerized controls in its information processing that check for accuracy, completeness, and proper authorization of transactions. Have the contractor identify and demonstrate controls related to each of the areas listed in a. through e. below. Compare the contractor disclosed controls with the generic access control listing contained in the referenced CAM section and identify any controls not incorporated in the application. Verify the existence and adequacy of the contractor disclosed controls. Discuss any apparent deficiencies with the contractor.</p>	
<p>a. Access Controls (CAM 5-1406.1)</p>	
<p>b. Data Input Controls (CAM 5-1406.2)</p>	
<p>c. Processing Controls (CAM 5-1406.3)</p>	
<p>d. Error Correction and Submission (CAM 5-1406.4)</p>	
<p>e. Output Controls (CAM 5-1406.5)</p>	
<p>5. Once the current accounting system information and communication processes are demonstrated by the contractor, selectively trace the processing of an accounting transaction through the accounting system starting from the initiation of the transaction (e.g., invoice payment) to validate your understanding of the accounting system. By tracing a transaction, the auditor should document the validity and operation of the key controls demonstrated by the contractor in steps 2-4 above</p>	

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<p>(e.g., subsidiary ledgers reconcile to general ledger, adequate segregation of duties, proper approval of adjustments). Discrepancies between your understanding and the contractor’s demonstration should be noted and resolved prior to completing the remainder of this examination.</p>	
<p>6. Document your confirmed understanding of the contractor’s accounting system information and communication processes and obtain a written confirmation from the contractor indicating that they agree with this understanding. This documentation will typically take the form of system flowcharts or narrative descriptions and can be prepared by the auditor or consist of documentation prepared by the contractor (see CAM 5-106). Based on your understanding of the contractor’s accounting system information and communication processes, document the impact that it will have on the nature and extent of testing of each control objective (W/Ps G and H).</p>	

F-1	Monitoring	W/P Reference
	Version <u>7.0</u> , dated July 2009	
	Monitoring is a process that assesses the quality of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. The auditor should develop a sufficient understanding of the contractor’s ongoing monitoring activities and/or separate evaluations related to the accounting system internal controls.	
	1. Determine if ongoing monitoring procedures are incorporated into the normal recurring activities of the contractor’s organization. These procedures should include regular management and supervisory activities.	
	2. Where applicable, determine the extent of internal audit involvement in performing monitoring functions through separate evaluations.	
	a. <u>Consider whether the contractor has an adequate internal audit plan for conducting internal control and compliance reviews considering the contractor’s other monitoring activities</u>	
	b. <u>Verify that there are effective follow-up procedures on internal audit recommendations.</u>	
	3. Determine and document the extent of monitoring activities being performed by external parties.	
	<u>4.3.</u> Document your overall understanding of the monitoring activity being performed at the contractor’s location and the impact it will have on	

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the nature and extent of testing of each control objective (W/Ps G and H).	
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G-1	Accounting System and Controls	W/P Reference
Version <u>7.0</u>, dated July 2009		
The auditor should obtain an understanding of the contractor's control activities for this control objective. A detailed understanding of the control activities is essential to the assessment of control risk. Accounting system primary control objectives, as they relate to U.S. Government contracts, and examples of control activities the contractor may have implemented to achieve the control objectives, are provided in the internal control matrix (see W/P 31). The audit procedures for this control objective are also included in the internal control matrix. If the auditor determines that relevant internal control activities do not exist, or that the effort to perform tests is not justified, no control testing need be performed, and control risk will be assessed as high.		
1. In planning the following audit procedures to understand the contractor's control activities, the auditor should recognize the other components of internal control and their impact on the nature and extent of testing to be performed. Document the impact of the internal control components on the nature and extent of testing on this control objective. Internal control components are as follows:		
• Control Environment		
• Contractor Risk Assessment		
• Information and Communications		
• Monitoring		
The auditor should ensure that the accounting system is well designed and is operating effectively to provide reliable accounting data and prevent misstatements that would otherwise occur.		
2. Determine that the contractor maintains a current description of the accounting system, including books of original entry, general and subsidiary ledgers, and any statistical and/or supporting records which demonstrate the initiation of transactions, the flow of documents, and the identification of all points where correcting, adjusting or other cost transfers can be entered into the system.		
3. Determine if the contractor maintains a chart of accounts which is updated in a timely manner.		
4. Verify that adequate written policies and procedures exist for		

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approving and documenting correcting, adjusting, closing, credit, and transfer entries.	
5. Verify that adequate procedures exist for reconciling all subsidiary cost ledgers and cost objectives to the general ledger accounts. If this is a computerized function, the auditor should document how this is accomplished and selectively test to verify that it is occurring properly.	
6. Verify that a trial balance is prepared on a regular basis and reconciles to the financial statements.	
7. Verify that adequate procedures exist for controlling monthly accrual calculations and that an adequate approval process is used.	
8. Verify that there is adequate segregation of duties and responsibilities in such areas as access to accounting records, check-signing authority, recording disbursements in cash journal, performance of bank reconciliations, etc.	
9. Determine whether policies and procedures require identification of systemic problems or trends based on error reports. Verify that corrections are processed in a timely manner.	
10. <u>Evaluate management intervention and/or overrides:</u>	
<u>a. Determine whether policies and procedures address the situations and frequency of management intervention, require documentation and approval of intervention, and the strict prohibition of any management overrides.</u>	
<u>b. If applicable, selectively evaluate documentation of management interventions or overrides for compliance with policies and procedures.</u>	
10 .11. Determine if the contractor has disclosed the use of non-GAAP financial measures in the filed financial statements. If so, determine if reliance is placed on any of this information for this audit or any related audits. If so, determine the impact on the assessment of control risk (the contractor is required to disclose the most directly comparable GAAP financial measure and it's reconciliation to the disclosed non-GAAP financial measure).	

H-1	Cost Allocations	W/P Reference
	Version 7.0, dated July 2009	
	The auditor should obtain an understanding of the contractor's control activities for this control objective. A detailed understanding of the control activities is essential to the assessment of control risk. Accounting	

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<p>system primary control objectives, as they relate to U.S. Government contracts, and examples of control activities the contractor may have implemented to achieve the control objectives, are provided in the internal control matrix (see W/P 31). The audit procedures for this control objective are also included in the internal control matrix. If the auditor determines that relevant internal control activities do not exist, or that the effort to perform tests is not justified, no control testing need be performed, and control risk will be assessed as high.</p>	
<p>The auditor should determine if management ensures that an item of cost or a group of items of cost are assigned to one or more cost objectives in accordance with rules and regulations and standards. Management ensures the proper allocation of both the direct assignment of cost and the reassignment of a share from an indirect cost pool.</p>	
<p>1. In planning the following audit procedures to understand the contractor’s control activities, the auditor should recognize the other components of internal control and their impact on the nature and extent of testing to be performed. Document the impact of the internal control components on the nature and extent of testing on this control objective. Internal control components are as follows:</p>	
<ul style="list-style-type: none"> • Control Environment 	
<ul style="list-style-type: none"> • Contractor Risk Assessment 	
<ul style="list-style-type: none"> • Information and Communications 	
<ul style="list-style-type: none"> • Monitoring 	
<p>2. Determine that the contractor's disclosure statement is current and adequately describes its accounting practices.</p>	
<p>3. Document, if applicable, any CAS noncompliances that may impact the internal control structure.</p>	
<p>4. Verify that adequate written policies and procedures exist for the identification and exclusion of unallowable costs. Determine that the detail and depth of records required as backup support for proposals, billings, or claims are adequate to establish and maintain visibility of identified unallowable costs (CAS 405).</p>	
<p>5. Verify that adequate written procedures exist to ensure that charge numbers are based on contractual requirements and are under management control and authorizations.</p>	
<p>6. Verify that adequate written procedures exist for adjusting costs charged to the Government for any income, rebates, allowances, or miscellaneous credits and that appropriate approvals are required.</p>	

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A-1	Concluding Steps	W/P Reference
Version 7.0, dated July 2009		
1. Assessment of Control Risk		
	a. Considering all five components of internal control (control environment, contractor risk assessment, information and communications, monitoring, and control activities that relate to control objectives), assess control risk for each of the relevant control objectives (accounting system and controls and cost allocations). For each of the objectives, summarize the characteristics which support the assessed level of control risk and specifically identify any internal control weaknesses or system deficiencies.	
	b. Determine if the accounting system is adequate to reasonably assure proper pricing, administration, and settlement of Government contracts in accordance with applicable laws and regulations.	
	c. Based on the assessments above, determine the impact on the scope of other audits.	
	d. Complete the ICAPS form at W/P A (see CAM 3-305).	
	e. Coordinate the results of audit with the supervisor. The supervisor and the FAO manager should review and initial the ICAPS form at W/P A before the exit conference is performed. If it is determined that additional audit steps are needed, any additional planned audit effort should be accomplished as part of this examination or immediately thereafter. Any delays in completing this audit effort should be documented and approved by management.	
2. Summary Steps		
	a. Prepare a draft audit report in accordance with CAM 10-400. If applicable, prepare a separate CAS noncompliance report.	
	b. Conduct an exit conference with the contractor in accordance with CAM 4-304.	
	c. Finalize the audit report incorporating the contractor's response and audit rejoinder.	
	d. If the contractor has EVMS covered contracts, provide comments in the audit report on whether any findings are likely to impact the contractor's EVMS (10-1204.5b). Discuss findings and	

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<p>recommendations relating to the EVMS with the Contract Administration Office EVMS Monitor prior to issuance of the report. Immediately evaluate the impact of these findings on specific EVMS covered contracts and provide the details in flash EVMS surveillance reports (11-203.5.b).</p>	
<p>e. Update the permanent file in accordance with CAM 4-405.b (MAAR 3). Retain a copy of the approved W/P A ICAPS form. After the audit report is issued, update the ICRS database using the information on the approved W/P A ICAPS form and file the approved W/P A ICAPS form in the Electronic Contractor Permanent File (ECPF). (The control risk assessment (Section II) and overall system opinion (Section III) in the ICAPS may not be updated until the system report supporting the change is issued (CAM 3-306a).)</p>	

Revised CAM Sections

5-306 Integrity and Ethical Values

a. Integrity and ethical values are the product of the entity's ethical and behavioral standards, how they are communicated and how they are reinforced in practice. Management should convey the message that integrity and ethical values cannot be compromised, and employees should receive and understand that message. Management should continually demonstrate, through words and actions, a commitment to high ethical standards.

b. FAR Subpart 3.10 includes general policies and procedures related to contractor code of business ethics and conduct that apply to all Government contractors. That provision requires Government contractors to conduct themselves with the highest degree of integrity and honesty. In addition, contractors should have a written code of business ethics and conduct, an employee business ethics and compliance training program, and an internal control system that:

- are suitable to the size of the company and extent of involvement in Government contracting;
- facilitate timely discovery and disclosure of improper conduct with Government contracts; and
- ensure corrective measures are promptly instituted and carried out.

c. Specific requirements are included in the contract clause at FAR 52.203-13 which is mandatory for all contracts in excess of \$5 million with a performance period of 120 days or more.

5-306.1 Codes of Business Ethics and Conduct

FAR 52.203-13(b) requires contractors to have a written code of business ethics and conduct, and to make a copy of the code available to each employee. Although FAR does not detail the specific areas that should be covered, the contractor's written code of conduct should generally address ethical business practices and expected standards of ethical and moral behavior. This code of conduct should cover dealings with customers, suppliers, employees, and other parties. In evaluating the adequacy of the contractor's written code of conduct, consider whether:

- Codes address conflicts of interest, illegal or other improper payments, anticompetitive guidelines, and insider trading.
- Codes cover compliance with Government contracting requirements for procurement integrity, classified information, and recruiting and employing current or former Government personnel.
- Codes are periodically acknowledged by all employees.
- Codes clearly establish what behavior is acceptable or unacceptable, and what to do if employees encounter improper behavior.
- Codes cite consequences for violations.

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5-306.2 Ethics Awareness and Compliance Program

FAR 52.203-13(c)(1) requires contractors to have an ongoing business ethics awareness and compliance program. The program should include periodically communicating the contractor's standards and procedures by providing effective training and otherwise disseminating information appropriate to an individual's respective roles and responsibilities. FAR requires that the training be provided to the contractor's principals and employees, as well as to the contractor's agents and subcontractors, as appropriate. Auditors should evaluate the contractor's ethics awareness and compliance training materials to ensure it covers the contractor's code of business ethics and conduct (5-306.1). Auditors should also test the implementation of the program by obtaining completed training documents to determine that the training was periodically provided to the appropriate individuals.

5-306.3 Business Ethics Awareness and Compliance Internal Control System

a. Contractors should establish and maintain an effective system of internal controls and self-governance and should not condone inappropriate practices. Management must continually communicate the importance of a strong internal control system. The contractor's business ethics awareness and compliance program should have policies and procedures to facilitate timely discovery of improper conduct and ensure corrective measures are promptly instituted and carried out for any cases of improper conduct disclosed. Timely discovery and prompt corrective measures should generally be the result of a strong system of internal controls and policies and procedures that provide for, at a minimum, the following (FAR 52.203-13(c)(2)(ii):

- (1) Assignment of responsibility at a sufficiently high level to ensure the effectiveness of the business ethics awareness and compliance program and internal control system. The manager responsible for the ethics program should report to a high level official such as the vice president or CFO.
- (2) Procedures to ensure individuals that previously engaged in conduct that conflicts with the contractor's code of conduct are not appointed as a principal of the company (e.g., officer, director, partner). Auditors should review the contractor's policies and procedures and test the procedures to verify that they include steps for exercising due diligence in identifying such conduct (e.g., require background checks before appointing principals of the company) and that the steps have been taken when applicable.
- (3) Periodic evaluations (i.e., at least annually) of the effectiveness of the business ethics and awareness compliance program and internal control system. Auditors should review the results of these evaluations and determine the impact on any audits. For example, if the contractor's recent evaluations disclosed weaknesses in the contractor's internal control system, the auditor should ensure the contractor has taken the necessary corrective actions to address these weaknesses.
- (4) Disciplinary action for improper conduct, or failing to take reasonable steps to detect improper conduct. Auditors should request the contractor provide evidence of the assessment performed to determine if disciplinary action taken was needed, and evidence of the disciplinary action taken, if applicable. Auditors should remember that it is appropriate for contractors to remove Personally Identifiable Information (PII) before submitting documentation to the auditor. If the contractor states that no disciplinary

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action was needed, the auditor should take steps to ensure that there were no reports of improper conduct by the contractor (such as those reported under the requirements discussed in 5-306.3a(6) below). If the auditor finds that there is a report of improper conduct and the contractor failed to take disciplinary action when it should have been taken, the auditor should cite the contractor for an internal control deficiency.

- (5) An internal reporting mechanism, such as a hotline, by which employees may anonymously or confidentially report suspected instances of improper conduct, and instructions that encourage employees to make such reports.
- (6) Timely disclosure in writing to the agency Office of Inspector General (OIG), with a copy to the contracting officer, when there is credible evidence of violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations, or a violation of the civil False Claims Act in connection with Government contracts. Auditors should ensure that the contractor's policies and procedures include a reasonable definition of credible evidence, and a reasonable timeframe for disclosure once credible evidence is obtained. Contractors are allowed to take time for preliminary examination of the evidence to determine its credibility prior to disclosure. Once the contractor has had sufficient time to take reasonable steps to determine that the evidence is credible, the contractor should disclose the violation in a timely manner. Auditors should verify that the contractor did not delay disclosing the violation once it was determined that credible evidence exists. If the auditor finds that the contractor failed to disclose the violation in a timely manner, an internal control deficiency should be reported. Review any disclosures reported to the OIG and contracting officer and ascertain if the contractor has taken the necessary corrective actions to protect the Government's interests. If the contractor has not taken the appropriate corrective action, the auditor should report this as an internal control deficiency. If any deficiencies are identified related to the requirement for timely disclosure to the agency OIG (FAR 52.203-13(c)(2)(ii)(F)), the DCAA Justice Liaison Auditor (DCAAHQJLA@dcaa.mil) will be included on the distribution for the audit report.
- (7) Full cooperation with any Government agencies responsible for audits, investigations, or corrective actions. If there are known cases where the contractor has not cooperated with audits or investigations, the contractor should be cited for deficiency relating to its control environment. Auditors should confirm that there are no outstanding access to records issues or subpoenas that would indicate the contractor's lack of cooperation.

b. Auditors should also consider whether any:

- access to records problems exist which may adversely impact the ability to assess the contractor's internal controls; or
- DCAA Form 2000s have been issued or current investigative activity indicates weaknesses in established internal controls.

5-306.4 Display of Hotline Posters

FAR 52.203-14 establishes contract requirements for the contractor's display of hotline poster(s) if the contractor has not implemented a business ethics and conduct awareness program,

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including a reporting mechanism. Generally, FAR requires, for contract performance in the United States, prominent display in common work areas of:

- Department of Homeland Security fraud hotline poster(s) identified by the contracting officer (required when the contract is funded with disaster assistance funds); and
- Agency hotline poster(s) (unless the contractor has implemented a business ethics and conduct awareness program, including a reporting mechanism).

In addition, FAR requires display of an electronic version of the hotline poster(s) on the company website if one is maintained for providing information to employees.

5-306.5 External Influences

External influences heighten management's consciousness of and attitude towards the conduct and reporting of an entity's operations and may prompt management to establish specific internal control policies or procedures. The auditor should be alert for external factors which may have an influence on management's attention to internal controls. For example, publicly traded companies registered with the SEC are subject to additional certification and reporting requirements as a result of the Sarbanes-Oxley Act of 2002. Public companies' principal executive and financial officers are required to certify to the financial information and certain aspects of internal control over financial reporting. Public companies are also required to include in their annual report a report of management on the company's internal control over financial reporting and the independent auditor's attestation on management's assessment. Additionally, auditors should consider whether the contractor's internal controls are subject to external audits by organizations other than DCAA.