



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

IN REPLY REFER TO

July 7, 2004  
04-PSP-036(R)

PSP 730.5.1

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA  
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Guidance on Performing and Reporting on Agreed-Upon Procedures Engagements

Summary

This memorandum is issued to provide clarifying guidance for performing and reporting on Agreed-Upon Procedures (AUP) engagements. This clarifying guidance will be incorporated in the January 2005 edition of the CAM.

An AUP engagement is one in which an auditor is engaged to perform procedures based on the needs of a requestor. The procedures must be mutually agreed-to in advance with the requestor and they should be specific, subject to measurable criteria, and not call for an audit opinion. The auditor should not agree to perform procedures that do not meet these criteria. The AUP report should state the specific procedures performed, the specific findings, and should not contain opinion-like language or negative assurance.

Background

Recent reviews of AUP reports have found that some contained unclear, vague, and inappropriate procedures, and opinion-like statements. Examples of agreed-upon procedures found in the AUP reports that are considered vague and not based on specific measurable criteria, and which probably contributed to opinion-like findings, are as follows:

- Evaluate the proposed MOU to determine if the Advance Agreement should be terminated,
- Evaluate the computer center savings,
- Evaluate the reasonableness of rates, and
- Review the marketing costs for allowability, allocability, and reasonableness.

Examples of opinion-like statements found in the AUP reports are as follows:

- The contractor's proposal .... is in noncompliance with CAS 403,
- We have accepted XYZ's classification of certain production overhead costs....,
- We concur with the contractor's proposed methodology for collecting these costs,
- We take no exception to the direct labor rates proposed,
- The contractor's proposed rates appear reasonable, and

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- We find no basis to take exceptions to the proposed rates as detailed below.

Reports were also found containing the auditor's opinion on the significance/ materiality of the findings. The attestation standards for agreed-upon procedures prohibit the auditor from considering materiality when reporting the findings from an AUP engagement, unless materiality thresholds were agreed to with the requestor.

## Examples of inappropriate findings based on materiality:

- Our review disclosed insignificant errors in the contractor's computation,
- No material discrepancies were found between the reported costs and the actual costs.
- Actual rates do not show a significant increase when compared to baseline rates.
- In our opinion, the amount proposed is insignificant.

## Guidance

## Agreement with Requestor on Procedures

Upon receipt of a request to perform an agreed upon procedures engagement, auditors should coordinate with the requestor to reach an agreement regarding the specific procedures to be performed. Auditors should not agree to perform procedures that are overly subjective and thus possibly open to varying interpretations and opinion-like conclusions. Statements on Standards for Attestation Engagements, AT Section 201.03, states that an agreed-upon procedures engagement is one in which a practitioner is engaged by the requestor to issue a report of findings based on specific procedures performed on the subject matter. The requestor engages the practitioner to assist in evaluating the subject matter or an assertion as a result of the needs of the requestor.

An auditor does not render an opinion on a contractor's assertion or subject matter during an agreed-upon procedure engagement. If the customer requests the auditor to render an opinion on certain contractor assertions (e.g., appropriateness of proposed rates), the auditor should consider performing an audit (e.g., Code 27000, Audit of Parts of a Proposal).

CAM 4-103 requires the auditor to (1) communicate directly with the requestor to establish a clear understanding regarding the procedures to be performed, and (2) confirm the discussions by issuing an acknowledgement letter that states the specific procedures agreed-upon for the assignment, in advance of performing field work. The acknowledgment letter should include a list of the procedures and evaluation criteria. See CAM Figure 4-1-3 for an example of an acknowledgement letter for agreed-upon procedures. The following are examples of appropriate agreed-to procedures that are specific and based on measurable criteria:

- Compare indirect expense rates contained in the XYZ proposal, dated August 12, 20XX, to the Forward Pricing Rate Agreement, dated June 30, 20XX.
- Verify the contractor's actual CY 2002 direct labor rates to its books and records.

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Reporting the Results of an Agreed Upon Procedure Engagement

The AUP report must identify the specific procedures performed and the specific findings from performing these procedures, and must not provide an audit opinion (either expressed or implied) or negative assurance. The attestation standards require that the auditor report all findings from the application of the agreed-upon procedures without considering materiality, unless materiality limits were agreed-upon with the requestor. Any agreed-upon materiality limits should be described in the report. For example, an auditor should not report that, "We noted no significant exceptions based on performing the agreed-upon procedures." The auditor should identify all differences noted as a result of performing the procedures. When no differences are found as a result of applying the agreed-upon procedures, the auditor may report "We found no exceptions based on performing the agreed-upon procedures."

Auditors should avoid opinion-like language when reporting the AUP findings. The following are examples of appropriate findings reportable under an agreed-upon procedure engagement:

- We compared the indirect expense rates contained in the XYZ proposal, dated August 12, 20XX, to the Forward Pricing Rate Agreement, dated June 30, 20XX, and found no exceptions.
- We verified the direct labor rates contained in the XYZ proposal, dated August 12, 20XX, to the direct labor bid rates, dated May 31, 20XX, and found no exceptions.

We have developed a training package (Enclosure) to assist in understanding the objectives and reporting requirements of AUP engagements. By December 31, 2004, FAOs should present this training during a staff conference. Upon completion of this training, auditors will be entitled to one hour of CPE credit under the Accounting and Auditing field of study.

We recommend that the Financial Liaison Auditors brief their cognizant contracting procurement offices on this clarifying guidance, adapting the presentation as necessary.

#### Concluding Remarks

FAO personnel should direct questions to their regional personnel. Regional personnel may direct questions to Mr. Jeff Shaffer, Program Manager, Special Projects Division, at (703) 767-3229 or e-mail at DCAA-PSP@dcaa.mil.

/Signed/  
Robert DiMucci  
Assistant Director  
Policy and Plans

#### Enclosure

Training Presentation – Agreed-Upon Procedures

DISTRIBUTION: C





# **Audit Guidance on Performing and Reporting on Agreed-Upon Procedures**

**July 2004**



# Audits vs. Agreed-Upon Procedures

- Purpose of Engagement

- ➔ Examination - Expresses an opinion on the contractor's assertion or subject matter
- ➔ Agreed-Upon Procedure - Reports on all findings based on specific procedures performed. No opinions are offered (either explicit or implied).



# Agreed-Upon Procedures Engagements Planning Steps

- The procedures should be:
  - ➔ specific and expected to generate reasonably consistent findings (e.g., mathematical verification)
  - ➔ subject to reasonably measurable criteria (e.g., traced to contractor's books and records for fiscal year ending 12/31/2003)



# Agreed-Upon Procedures Engagements Planning Steps

- Prior to beginning the engagement, coordinate with the customer to reach a mutual agreement and obtain a clear understanding on the specific procedures to be performed.
- The customer, not the auditor, takes the responsibility for establishing the scope of the agreed-upon procedures, because the customer has the best understanding of his/her specific needs.
- An auditor should not agree to perform inappropriate procedures under an AUP engagement (i.e., procedures that would call for an audit opinion or are overly subjective and not subject to measurable criteria.)



# Agreed-Upon Procedures Engagements Planning Steps

- Agreed-upon procedures should be specific, and not be vague or overly subjective, which could possibly lead to varying interpretations.
- Terms of uncertain meaning (such as general review, limited review, check, or test) should not be used in describing the procedures unless such terms are defined within the agreed-upon procedures.
- Agreed-upon procedures should not call for opinion-like findings. For example, a request to “evaluate rates,” where the requestor is asking for an audit opinion on rates, should be set up as a Code 27000, Audit of Part(s) of a Proposal (CAM 9-108), in lieu of an agreed-upon procedure assignment.



# Agreed-Upon Procedures Engagements Planning Steps

## Examples of Code 28000 Specific Procedures

- Compare and report the differences between:
  - ➔ Proposed direct labor hours and current plant-wide standards
  - ➔ Proposed direct labor rates and current payroll actual rates
  - ➔ Proposed indirect expense rates and actual rates for FY 2003
- Determine if the proposed direct labor and indirect expenses rates are based on the contractor's most current forward pricing rate agreement.



# Agreed-Upon Procedures Engagements Planning Steps

## Examples of Code 17900 Specific Procedures

- Trace June 2003 billed direct costs to the contractor's general ledger.
- Trace June 2003 billed direct labor hours to the contractor's labor distribution records.
- Verify billed direct labor rates included in the contractor's June 2003 billing to the contract terms.



# Agreed-Upon Procedures Engagement Examples

<b>Inappropriate Procedure</b>	<b>Appropriate Procedure</b>
Verify the proposed O/H rate.	Calculate the actual 1999 O/H rate incurred using XYZ's trial balance, dated 12/31/99, and compare the resultant rate to the rate proposed.



# Agreed-Upon Procedures Engagement Examples

<b>Inappropriate Procedure</b>	<b>Appropriate Procedure</b>
Review claimed material items.	Select the 5 highest dollar material items and compare amount claimed to vendor invoices.



# Agreed-Upon Procedures Engagement Questions and Answers

- What type of service should we provide (21000, 27000, or 28000)?
  1. The requestor wants us to “review the direct labor and indirect expense rates for reasonableness.”
  2. The requestor wants us to determine if certain equipment actually exists and to verify the reported values to the books and records. The major portion of the proposed indirect rates include depreciation associated with this equipment. The requestor does not care whether or not the results of our effort are conveyed as an audit opinion.
  3. The requestor wants an audit of a proposal.



# Agreed-Upon Procedures Engagement Questions and Answers

- Requestor asks us to evaluate the direct labor and indirect expense rates. Are we to set up a 27000 or 28000 assignment?
  - ➔ “Evaluate” is too generic for us to be sure what the requestor is requesting; i.e., an examination or an application of AUP. Communicate with the requestor to determine what type of service the requestor needs, particularly when the wording of the request uses a generic term like “evaluate.”



# Agreed-Upon Procedures Engagements

## Planning Steps

- If the customer's request letter does not clearly establish the procedures to be performed, the auditor should discuss it with the customer and come to an agreement on the procedures to be applied before the acknowledgment letter is sent.
- Auditing standards require auditors to establish a clear understanding of the terms of the engagement with the customer. Auditors should confirm their understanding through an acknowledgment letter that lists the specific procedures agreed-upon for the assignment (CAM 4-103d)



# Agreed-Upon Procedures Engagements Planning Steps

The following should be included in the acknowledgment letter (CAM 4-103.d.):

- Nature of engagement (i.e., an application of agreed-upon procedures)
- Identification of the contractor documentation (subject matter) to which the agreed-upon procedures are to be applied, and the fact the contractor is responsible for the contents
- Identification of the specified users of the report
- Confirmation of requestor's responsibility for the sufficiency of the procedures to be performed



# Agreed-Upon Procedures Engagements Planning Steps

## Acknowledgment letter (continued)

- Responsibility of DCAA to perform in accordance with applicable professional standards (GAGAS).
- Listing of agreed-upon procedures and assessment criteria.
- (If applicable) Assistance to be provided to DCAA by requestor.
- (If applicable) Involvement of any specialists from outside of DCAA.
- Disclaimer of Opinion will be included in the report.
- Any Agreed-Upon Materiality Limits.



## Performance of Agreed-Upon Procedures

- Procedures may be modified during the course of the engagement - provided specified users agree and accept responsibility.
- The procedures agreed to and the evidence derived from the performance of the procedures are the basis for expressing the findings in the report.



# Agreed-Upon Procedures Engagement Report

## ● Subject paragraph:

- ➔ state the nature of the engagement and the subject matter/assertion
- ➔ state the procedures were mutually agreed-upon
- ➔ state the fact that the contractor is responsible for the contents of the subject matter (i.e., submission)
- ➔ exclude the responsibility paragraph of the auditor because an audit was not performed



# Agreed-Upon Procedures Engagement Report

## ● Scope paragraph:

- ➔ Reference GAGAS
- ➔ List the specific procedures performed
- ➔ State the sufficiency of the procedures is the responsibility of the requestor
- ➔ Identify any materiality limits established with the requestor
- ➔ Include restrictions on procedures (NOT qualifications), if appropriate
- ➔ Exclude the traditional paragraph regarding evaluation criteria and control risk because an examination or review was not performed.



# Agreed-Upon Procedures Engagement Report

## ● Results paragraph:

- ➔ Disclaim an opinion
- ➔ Provide factual results/findings for each procedure performed. Findings should be presented in an exhibit type format with appropriate notes that identify the procedures performed and related findings.
- ➔ Exclude overall conclusions and opinion-like language
- ➔ State that if other procedures had been performed, other matters may have been identified and reported



# Agreed-Upon Procedures Engagement Report

## ● Results paragraph (con't):

- ➔ Report all findings resulting from performing the AUP unless agreed-to materiality limits indicate otherwise
- ➔ Knowledge of matters outside Agreed-Upon Procedures
  - Report other information that comes to the auditor's attention that may have a significant impact on the use of the AUP findings as "Other Matters to be Reported"



# Agreed-Upon Procedures Engagement Report

## ● Additional DCAA Guidance (CAM 10-1000)

- ➔ Do not use the word “Audit” in title or section headings (use “Agreed-Upon Procedures”)
- ➔ The report number is revised to delete the word “Audit” - just “Report No. xxx”
- ➔ Use the word “engagement” to describe the work performed
- ➔ Nature of engagement should be described as “agreed-upon procedures” rather than “audit,” “examination,” or “review”
- ➔ Results should be expressed as “differences” or “findings” rather than “questioned costs” or “recommended costs”



# Agreed-Upon Procedures Engagement Findings - Examples

<b>Procedure</b>	<b>Inappropriate Finding</b>	<b>Appropriate Finding</b>
Calculate the actual 1999 O/H rate incurred using XYZ's trial balance dated 12/31/99 and compare the resultant rate to the rate proposed	The proposed rate appears to be reasonable when compared to the actual 1999 rate.	No differences were found as a result of applying the agreed-upon procedure.



# Agreed-Upon Procedures Engagement Findings - Examples

<b>Procedure</b>	<b>Inappropriate Finding</b>	<b>Appropriate Finding</b>
Select a random sample in accordance with agreed-to sampling plan of claimed material items and compare amount claimed to vendor invoices.	We noted no significant exceptions to the claimed material costs.	We selected a random sample of 40 items which represented 63% of the claimed costs. All selected items agreed with the vendor invoice except for the following:



# Agreed Upon Procedures Engagement Questions and Answers

- The Results paragraph starts with the appropriate disclaimer of opinion. Which finding is an acceptable comment?

Example 1:

Option 1: Proposed indirect rates are reasonable as they agree with those contained in the latest FPRA.

Option 2: Proposed indirect rates agree with those contained in the latest FPRA.



# Agreed-Upon Procedures Engagement Questions and Answers

## Example 2:

Option 1: The application of agreed-upon procedures disclosed the costs on voucher number 123 are acceptable as claimed. The incurred costs agreed with ABC's books and records; the correct billing rates were applied; and the billed amounts did not exceed the authorized funding amounts according to the contract.

Option 2: The application of agreed-upon procedures disclosed the claimed costs on voucher number 123 agreed with those recorded on ABC's books and records; include application of the ACO approved billing rates; and the billed amounts did not exceed the authorized funding amounts according to the contract.



# Agreed-Upon Procedures Engagement Questions and Answers

## Example 3:

Option 1: We verified ABC's computation of claimed severance pay of \$536,121 for 2002 to the formula included in its Policy No. HR-123. The claimed amount was not computed in accordance with the formula in the established policy. Our calculations result in \$150,995 less than the amount computed by the contractor.

Option 2: Our review of ABC's claimed severance pay of \$536,121 for 2002 resulted in a recommended cost of \$385,126. The questioned cost of \$150,995 is due to the misapplication of the formula in ABC's established policy on severance payments.



# Agreed-Upon Procedures Engagement Structured Note Example

**Summary of Findings:** The claimed amount was not computed in accordance with the formula in ABC's policy No. HR-123. Our calculations result in \$150,995 less than the amount computed by the contractor.

**Basis of Contractor's Submission:** The contractor claims the severance payment was calculated in accordance with the formula in ABC Policy No. HR-123.

**Agreed-Upon Procedure:** We verified ABC's computation of claimed severance pay of \$536,121 for CY 2002 to the formula included in its Policy No. HR-123.

**Contractor's Reaction:** The contractor concurred with our recalculation.



# Agreed Upon Procedures Engagement APPS Tool Bar

# AUP

- Designed to be run against AUP reports, this tool searches the document for instances where the following words might be used inappropriately.
  - ➔ Audit, review, examine, reasonable, accepted, significant, and question
- When one of these keywords is found, the user is shown the word in the context it is being used. The user should consider re-wording this section to appropriately report the agreed-upon procedure or finding.