

Master Document – Audit Program

Activity Code 13020		Compensation System Audit
Version 3.0, dated April 2004		
B-1	Planning Considerations	
Purpose and Scope		
The major objectives of this audit are to:		
<ul style="list-style-type: none"> • Obtain a sufficient understanding of the contractor’s Compensation System and related internal control (including both manual and computerized activities) to plan related contract audit effort. This requires that the auditor assess the adequacy of the contractor’s policies and procedures, whether they have been implemented, and if they are working effectively. 		
<ul style="list-style-type: none"> • Document the understanding of the Compensation System internal control in working papers and permanent files (see CAM 5-100). 		
<ul style="list-style-type: none"> • Test the operational effectiveness of Compensation System internal controls. 		
<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 Compensation System internal control and assessment of control risk and the adequacy of the system for Government contracts. 		
<p>This audit is limited to the examination of the Compensation System and related internal controls for major contractors, non-major contractors where the system is considered significant, and other contractors with substantial negotiated firm-fixed price contracts. Only those controls directly related to the contractor’s Compensation System, as defined below, will be audited under this assignment. Controls for interrelated audit concerns regarding the adequacy of the contractor’s other major systems (i.e., Labor, Estimating, 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 on the Compensation System internal control. The results of this audit should be commented on in reports on related audit areas.</p>		
<p>When performing an update or follow-up examination, the steps below 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 be alert for internal control evaluations performed by the contractor or its external auditor relating to this audit area.</p>		

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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.
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.
The use of computers of all kinds in a contractor’s accounting and management systems is so pervasive it is unlikely 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 System (IS) Auditing Knowledge Base that is contained on DCAA’s Intranet, prior to the initiation 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 contact their regional offices to obtain the necessary expertise.
The internal control matrix shows the interrelationships among the control objectives, control activities, and audit procedures used in this audit. 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 control activities and the interrelationships in a matrix format.

B-1	Preliminary Steps	WP Reference
Version 3.0, dated April 2004		
1. Research and Planning		
	a. Become familiar with applicable sections of CAM (5-800, 6-413, 6-414) and any recent Headquarters guidance not incorporated in the CAM. Also read CAM 4-702.3 for consideration of fraud indicators specific to the area of examination.	
	b. Evaluate the extent and results of the contractor’s self-governance activities; e.g., internal and external audits, coordinated audits, etc., related to the Compensation System. 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 evaluation.	
	c. Evaluation the permanent file for:	
	(1) Existence of contractor compensation policies and procedures.	

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(2) Organization charts depicting the functional areas responsible for the processing of compensation related data.			
(3) Compensation System flowcharts providing a pictorial overview of all manual and computerized processing steps.			
(4) Information systems documentation:			
(a) Pertinent record layouts of files created and/or used during the processing of compensation related transactions.			
(b) Database table definitions.			
(c) Source documents.			
(d) Information on the conversion of documents to computer media.			
(e) Subsidiary or master files affected by the system.			
(f) Relevant reports, journals, and ledgers produced in the flow of information to the compensation reports.			
(5) Listings of current Government contracts.			
(6) Previous system audits performed. Check if the system is applicable, and if applicable, determine if it is relevant to the current system audit:			
	System	Applicable?	Relevant?
	Accounting		
	Billing		
	Budget (Planning)		
	Compensation		
	IT		
	Estimating		
	Indirect/ODC		
	Labor		
	Material		
	Purchasing		
(7) Audit lead sheets.			
(8) The analysis of the control environment and the results of any other audits, for internal control weaknesses that may impact this examination.			
d. Discuss the planned examination of the Compensation System internal controls with the administrative contracting officer and, if			

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appropriate, other customers to identify, understand, and document any concerns they may have or areas which should be evaluated.	
<p>e. 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 • CAM Figure 4-7-3. <p>Document in working paper B any identified fraud risk indicators and your response/action 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>	
2. Entrance Conference and Preparation	
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.	
b. Conduct an entrance conference as outlined in CAM 4-302, with particular emphasis on:	
(1) Requesting the contractor to provide, if applicable (see “Information and Communications step 4.), a demonstration of the Compensation System transaction flow including data input, data processing, data output, and related internal controls.	
(2) Any changes in the compensation processing job stream since the last audit.	
(3) The contractor’s monitoring process to ensure that established manual and computerized controls are functioning as intended.	
(4) Any identified weaknesses which may have been reported and related follow-up actions taken.	
3. Other Preliminary Steps	
a. Determine the compensation process employed by the contractor	

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and to what degree a computerized system is used.	
b. Perform a high level cursory evaluation to determine if the following exist:	
(1) A functional organization with defined organizational responsibilities.	
(2) A written description of the work flow in the compensation process.	
(3) Policies and procedures for effectively controlling the process.	
4. Initial Risk Assessment	
Using the information in steps 1, 2, and 3, prepare an initial risk assessment to determine the scope of the examination (W/P B).	

C-1	Control Environment	WP Reference
Version 3.0, dated April 2004		
<p>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 effectiveness of the Compensation System internal controls. The auditor should recognize those aspects of the contractor’s Compensation System that are automated and should ensure that the related control activities adequately address this automation by performing adequate auditing procedures.</p>		
<p>1. Obtain a copy of the most recently completed ICAPS for the Control Environment and Overall Accounting controls. Consider the rationale behind any moderate or high-risk assessment ratings and determine the impact, if any, on the effectiveness of the compensation system internal controls.</p>		
<p>2. If an examination of the control environment has not been recently performed, evaluate all documented prior audit experience with the contractor, including permanent files, relevant audit reports and working papers, suspected irregular conduct (SIC) referrals and discussions with prior auditors. Obtain an understanding of the following factors:</p>		

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<ul style="list-style-type: none"> • Integrity and ethical values. 	
<ul style="list-style-type: none"> • Commitment to competence. 	
<ul style="list-style-type: none"> • Board of directors and/or audit committee participation. 	
<ul style="list-style-type: none"> • Management’s philosophy and operating style. 	
<ul style="list-style-type: none"> • Organizational structure. 	
<ul style="list-style-type: none"> • Assignment of authority and responsibility. 	
<ul style="list-style-type: none"> • Human resource policies and procedures. 	
3. Document the overall assessment of the control environment and the impact that it has on the examination of the Compensation System.	

D-1	Contractor Risk Assessment	WP Reference
Version 3.0, dated April 2004		
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 establishment of reasonable compensation.		
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.		

E-1	Information and Communications	WP Reference
Version 3.0, dated April 2004		
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		

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<p>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.</p>	
<p>1. Since the accounting and IT systems are integral components of information and communication processes, obtain a copy of the most recently completed Internal Control Audit Planning Summaries for the Environment and Overall Accounting Controls and the IT System General Internal Controls. Evaluate the rationale behind any moderate or high-risk assessment ratings and determine the potential impact, if any, on the effectiveness of the Compensation System internal controls. Document your evaluation.</p>	
<p>2. Evaluate relevant permanent files, prior audit working papers, and any prior contractor demonstrations of its Compensation System information and communication processes. Document your evaluation.</p>	
<p>3. Determine if the contractor has made changes to the information and communication processes in its Compensation 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 Compensation 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 activities outlined in CAM 5-800.</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 compensation (labor) related 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 (CAM 5-1406.1)</p>	
<p>b. Input (CAM 5-1406.2)</p>	
<p>c. Processing (CAM 5-1406.3)</p>	
<p>d. Error Correction and Resubmission (CAM 5-1406.4)</p>	
<p>e. Output (CAM 5-1406.5)</p>	
<p>5. Selectively trace amounts through the Compensation System to validate your understanding of the information and communication</p>	

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processes in the Compensation System. Discrepancies between your understanding and the contractor’s demonstration should be resolved prior to completing the remainder of this examination.	
6. Document your confirmed understanding of the contractor’s Compensation 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).	

F-1	Monitoring	WP Reference
Version 3.0, dated April 2004		
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 Compensation 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.		
3. Determine and document the extent of monitoring activities being performed by external parties.		
4. Document your overall understanding of the monitoring activity being performed at the contractor’s location and determine the impact it will have on our examination of the Compensation System.		

G-1	Management Reviews	WP Reference
Version 3.0, dated April 2004		
The contractor performs management reviews of the pay administration department to monitor the integrity of the Compensation System. The following audit procedures are designed to gain an understanding of the contractor's control activities (policies and procedures) for the subject		

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<p>control objective. Refer to the Internal Control Matrixes (ICMs) to view the control objective, its associated control activities, and audit procedures in a matrix format. In determining the steps needed to obtain a sufficient understanding of the contractor's control activities, the auditor should utilize knowledge obtained in understanding the other components of the internal control (control environment, contractor risk assessment, information and communications, and monitoring). The auditor should recognize those aspects of the contractor's Compensation System that are automated and should ensure that the related control activities adequately address this automation by performing the audit procedures set forth below.</p>	
<p>1. Determine whether management reviews of the Compensation System have been performed. Evaluate the results and note any deficiencies.</p>	
<p>2. Determine if any required corrective action was taken or why no action was taken.</p>	
<p>3. Selectively evaluate the nature and extent of management review efforts to determine the extent to which we can rely on their effort (See CAM 4-1000) and adjust the scope of this audit accordingly.</p>	

H-1	Organization	WP Reference
	<p>Version 3.0, dated April 2004</p>	
	<p>The contractor's pay administration function is organized on the basis of a definitive flow of authority. The following audit procedures are designed to gain an understanding of the contractor's control activities (policies and procedures) for the subject control objective. Refer to the Internal Control Matrixes (ICMs) to view the control objective, its associated control activities, and audit procedures in a matrix format. In determining the steps needed to obtain a sufficient understanding of the contractor's control activities, the auditor should utilize knowledge obtained in understanding the other components of the internal control (control environment, contractor risk assessment, information and communications, and monitoring). The auditor should recognize those aspects of the contractor's Compensation System that are automated and should ensure that the related control activities adequately address this automation by performing the audit procedures set forth below.</p>	
	<p>Obtain and evaluate organization charts and/or discuss the organization of the pay administration function with the contractor to determine if</p>	
	<p>a. There are clear lines of authority.</p>	
	<p>b. Duties and responsibilities are defined to include responsibility for establishing, reviewing, and approving pay-range structure</p>	

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changes, starting pay rates, and pay increases.	
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I-1	Policies and Procedures	WP Reference
Version 3.0, dated April 2004		
<p>The contractor has and complies with written policies and procedures to reasonably assure that compensation paid to employees and charged to Government contracts is reasonable. The following audit procedures are designed to gain an understanding of the contractor's control activities (policies and procedures) for the subject control objective. Refer to the Internal Control Matrixes (ICMs) to view the control objective, its associated control activities, and audit procedures in a matrix format. In determining the steps needed to obtain a sufficient understanding of the contractor's control activities, the auditor should utilize knowledge obtained in understanding the other components of the internal control (control environment, contractor risk assessment, information and communications, and monitoring). The auditor should recognize those aspects of the contractor's Compensation System that are automated and should ensure that the related control activities adequately address this automation by performing the audit procedures set forth below.</p>		
1. Verify that the contractor has policies and procedures for:		
a. Wage and salary structure.		
b. Internal equity (job analysis, job descriptions and job evaluations).		
c. External equity (pay policy, relevant market, external pay surveys and market comparisons).		
d. Fringe benefits provided to employees		
e. Methods to determine pay increases and promotions.		
f. The performance appraisal process.		
2. Selectively evaluate the contractor's current compensation structure to determine if established policies and procedures were followed.		

J-1	Training	WP Reference
Version 3.0, dated April 2004		
<p>Pay administration employees receive training to perform pay administration tasks. The following audit procedures are designed to gain an understanding of the contractor's control activities (policies and procedures) for the subject control objective. Refer to the Internal Control</p>		

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<p>Matrixes (ICMs) to view the control objective, its associated control activities, and audit procedures in a matrix format. In determining the steps needed to obtain a sufficient understanding of the contractor's control activities, the auditor should utilize knowledge obtained in understanding the other components of the internal control (control environment, contractor risk assessment, information and communications, and monitoring). The auditor should recognize those aspects of the contractor's Compensation System that are automated and should ensure that the related control activities adequately address this automation by performing the audit procedures set forth below.</p>	
<p>1. Obtain a listing of training classes given to pay administration employees.</p>	
<p>2. Evaluate the training materials to determine that the training places emphasis on assuring that compensation is reasonable in accordance with acceptable management pay policies.</p>	
<p>3. Selectively evaluate evidence that pay administration employees have been trained, (e.g., evaluate training records, evaluate attendance rosters, interview employees).</p>	

A-1	Concluding Steps	WP Reference
	Version 3.0, dated April 2004	
	1. Assessment of Control Risk	
	<p>a. Considering all five components of internal control, assess control risk for each of the relevant control objectives. 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.</p>	
	<p>b. Determine if the system is adequate to reasonably assure proper pricing, administration, and settlement of Government contracts in accordance with applicable laws and regulations.</p>	
	<p>c. Based on the assessments above, determine the impact on the scope of other audits.</p>	
	<p>d. Update the Internal Control Audit Planning Summary (see CAM 3-305)</p>	
	<p>e. Coordinate the results of audit with the supervisor. The supervisor and the FAO manager should review and initial the ICAPS before the exit conference is performed. If it is determined that additional audit steps are needed, any additional planned audit effort should</p>	

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<p>be accomplished as part of this examination or immediately thereafter. Any delays in completion of this audit effort should be documented and approved by management.</p>	
<p>2. Summary Steps</p>	
<p>a. Prepare a draft audit report in accordance with CAM 10-400.</p>	
<p>b. Conduct an exit conference with the contractor in accordance with CAM 4-304.</p>	
<p>c. Finalize the audit report incorporating the contractor's response and audit rejoinder.</p>	
<p>d. Update the permanent file in accordance with CAM 4-405.1.b (MAAR #3).</p>	
<p>3. Closing Actions</p>	
<p>Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented (e.g., by initials and date on the CD or working paper folder, etc.) and should include:</p>	
<p>a. The title, author, and keywords fields of the file properties in the audit report must be completed (for the audit report only) prior to final filing.</p>	
<p>b. Review the APPS exe file for size. APPS-generated executable files that are over 10 megabytes in size should be reviewed to ensure that the format and content justify the size. Supervisors are responsible for reviewing or designating someone to review these files for content and format.</p>	
<p>c. Review the APPS exe file for temporary files. These files can be recognized by the “~\$” or “~WRL” at the beginning of the file name. Once the APPS exe file is complete and there is NO ACTIVITY to be completed on any of the files contained within the exe file, any temporary files should be deleted so there are no unintentional versions of working papers and/or reports. NOTE: This should be done prior to invoking the Export/Archive Option in APPS.</p>	
<p>d. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should</p>	

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<p>be password protected. The electronic file should then be renamed according to the convention “01 DCAA Report [RORG-ASSIGNMENT NO.] – Final.doc” and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes. For Memorandums the word “Report” would be replaced by “MFF” or “MFR” in the naming convention as appropriate.</p>	
<p>e. When the audit report is transmitted electronically to the requestor, the transmission email should be saved as a txt file (this will ensure the attachments are not saved again). Saving delivery or read receipts is optional. If saved, the naming convention should distinguish them from transmittal emails.</p>	
<p>f. Once the report is signed, the signature page of the audit report must be scanned in accordance with Agency standard scanning instructions. For audit packages, the scanned signature page file should be named the same as the audit report (see above) with “-sig” added (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.pdf). There is no requirement to make the file a part of the APPS generated executable file and it must be included separately in the iRIMS folder. There is no need to scan the signature page of a Memorandum unless it is distributed outside of DCAA.</p>	
<p>g. Ensure an electronic copy of the final draft audit report containing the supervisory auditor’s initials and date, cross-referenced to the working papers, is included in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.</p>	
<p>h. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.</p>	
<p>i. Two complete sets of electronic working papers should be filed. One set (official) will be filed in iRIMS. A second set (backup) will be stored on removable media in the hard copy working paper folder. The new APPS naming convention (ex: 01701-2003A10100001_Archive_093003.exe) will be used for both. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.</p>	
<p>j. Verify using a separate machine, that electronic files stored on removable media are not corrupted and can be unarchived. Indicate the test was successful by placing tester initials and date</p>	

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prominently on the CD label.	
k. Securely enclose the “backup” set of electronic files (CD) and any “official” set of hard copy in the hard copy folder.	
l. File the “official” set of electronic files in iRIMS (see iRIMS User Guide).	
m. <u>Do Not File Sensitive Audits in iRIMS</u> : Sensitive audits include but are not limited to classified work, suspected irregular conduct, hotline or DCAA Form 2000 related files. These audits should not be filed in iRIMS at this time. See CAM 4-407f for filing instructions.	