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## Chapter 3—Standards for Attestations and Audits

### 3.1—Background

[References: 23 U.S.C. Section 112(b)(2)(C), 48 CFR Part 31]

Most State departments of transportation (DOTs) award contracts for engineering and related services using Qualifications Based Selection (QBS) procedures. Under QBS, engineering consultant selections are based solely on elements of qualification, without consideration of price; accordingly, engineering consultants do not submit bids or priced proposals to be used as a basis for selection. Once a State DOT has made a selection based on the engineering consultant's qualifications, contract prices are negotiated based on the engineering consultant's estimated costs, which should be based on actual costs incurred in prior periods. These prices must be reasonable for the work to be performed.

23 U.S.C. Section 112(b)(2)(C) requires contracts for engineering services to be performed and audited in compliance with the costs principles contained in Part 31 of the Federal Acquisition Regulation (FAR). Because State DOTs construct highway improvements using both State and Federal funds, most State DOTs use rules for selection and pricing of state-funded engineering consultant contracts that incorporate, or are similar to, Federal rules.

*Note: The timing and types of audits performed to meet Federal requirements may vary between contracts, depending on State DOT procedures and other circumstances. Audits are performed to obtain reasonable assurance that consultant contract pricing is based on actual costs incurred, in compliance with FAR Part 31 and specific contract provisions.*

### 3.2—Engagement Types

Contract engagements generally include the following:

#### A. Review of Indirect Cost Rates for Costs Incurred

This type of engagement requires an examination of the engineering consultant's indirect cost rate(s) for a specified period (usually a calendar or fiscal year). In addition to ensuring that unallowable costs have been removed from overhead, the auditor should ensure that allowable costs have been correctly measured and properly allocated. Indirect cost rates established in these engagements are used to adjust costs previously invoiced at provisional rates to actual costs.

Many State DOTs also use established indirect cost rates of the most recently completed calendar or fiscal year as provisional rates to be used for estimating and invoicing costs on new contracts. In applying these provisional rates, risk and materiality must be measured, with due consideration given to all contracts that may be priced using the indirect cost rates.

#### B. Indirect Cost Rate (Forward Pricing) Review

This type of engagement requires an examination of the engineering consultant's forward pricing indirect cost rate(s) used to prepare estimates of costs that will be incurred in future periods. Forward pricing rates are similar to cost-incurred rates described above in Section 3.2.A in that forward pricing rates are based on historical costs. However, these rates are adjusted to reflect estimates of future costs and activity levels to project indirect cost rates for future periods.

When reviewing forward pricing rates, auditors should evaluate the reasonableness of future projections as well as the accuracy of historical cost information used as the starting point for rate development. While most contracts negotiated directly with Federal agencies utilize forward pricing rates, many DOTs only will negotiate contracts using indirect cost rates based on actual, historical cost information. Risk and materiality should be determined based on all contracts that may be priced using the indirect cost rate.

#### C. Contract Pre-Award Review

Contract pre-award reviews are performed to evaluate the reasonableness and accuracy of cost proposals for specific contracts. The auditor may examine the reasonableness of estimates used as well as the accuracy of estimate components that are based on current or historical costs. When conducting pre-awards reviews, auditors often rely on work done by other auditors; however, if other audit reports do not exist, then auditors performing the pre-award review may examine items such as indirect cost rates. Risk and materiality should be determined based only on the contracts being covered by the pre-award review. Auditors may be required to perform additional work for very large contracts.

#### D. Contract Cost Review

These engagements are performed to determine actual costs incurred on contracts. Auditors should consider both direct and indirect costs, to determine whether invoiced costs were allowable in accordance with applicable cost principles and were treated consistently with cost accounting practices used to develop the engineering consultant's indirect cost rate(s). When conducting such engagements, auditors often rely on opinions rendered by indirect cost rate auditors, including conclusions reached about the accounting and internal control systems. Risk and materiality should be determined based only on the contracts being covered by the contract cost review.

### **3.3—Auditing Standards**

Auditing procedures and responsibilities may vary, depending on the nature of the audit or examination-level attestation performed by the auditor. Several regulatory bodies may influence the types of procedures that will apply to planning the audit, performing audit testing, and reporting on the results. A description of applicable auditing standards follows.

#### A. Government Auditing Standards ("Yellow Book" or "GAGAS" Standards)

The Government Auditing Standards, also known as "Generally Accepted Government Auditing Standards" (GAGAS), are issued by the U.S. Government Accountability Office (GAO). GAGAS apply to audits of government entities as well as audits of Federal-aid funds paid to engineering consultants, non-profit organizations, and other non-governmental organizations.

GAGAS may be used in conjunction with professional standards issued by other authoritative bodies. For example, the AICPA has issued professional standards that apply to financial audits and attestation engagements performed by CPAs. GAGAS incorporate the AICPA's field work and reporting standards and, unless specifically excluded, also incorporate the related statements on auditing standards for financial audits. GAGAS incorporate the AICPA's general standard criteria, and the field work and reporting standards and the related statements on the standards for attestation engagements, unless specifically excluded.

**Note:** GAGAS also prescribe requirements in addition to those provided by the AICPA; accordingly, auditors may need to apply additional standards, depending on the purpose and requirements of the audit or attestation engagement.

## B. GAGAS Engagement Types

GAGAS categorize engagements into three types: (1) Financial Audits, (2) Attestation Engagements, and (3) Performance Audits. These engagement types are discussed in the following paragraphs. The standards to be applied will vary based on the engagement type and audit objectives.

### 1. Financial Audits

In performing a financial audit, the auditor is primarily concerned with providing reasonable assurance about whether financial statements are presented fairly, in all material respects, in conformity with GAAP or with a comprehensive basis other than GAAP. An example would be an audit of an indirect cost rate schedule (a special-purpose financial statement) performed in compliance with FAR Part 31. Financial audits also may include other objectives that provide different levels of assurance and entail various scopes of work.

### 2. Attestation Engagements

Attestation engagements concern examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results. These engagements may cover a broad range of financial or nonfinancial subjects and can be part of a financial audit or performance audit. Examples include examining an entity's internal control over financial reporting, an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants, and various prospective financial statements or pro-forma financial information.

### 3. Performance Audits

Performance audits entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a specific program. These audits generally are performed to improve program operations and may encompass a wide variety of objectives. Examples include whether legislative, regulatory, and/or organizational goals are being achieved, the relative cost and benefits of a program, and the validity and reliability of performance measures.

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*Note: This guide primarily deals with financial audits and attestations,<sup>8</sup> and auditors should review the full text of GAGAS to determine the applicable standards for these types of engagements. Standards may vary, depending on the type of audit or attestation engagement, and additional audit standards and procedures (e.g., standards issued by the Institute of Internal Auditors and/or Federal agencies) may be appropriate, depending on the circumstances.*

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## **3.4—Opinion on Internal Control**

### **[Reference: Sarbanes-Oxley Act of 2002]**

The Sarbanes-Oxley Act of 2002 was major legislation that affected publicly-traded companies. It established the Public Company Accounting Oversight Board (PCAOB), which has the authority to set auditing standards for registered public accounting firms involved with publicly-traded companies. One key provision is the requirement that annual reports must include an internal control report from management, along with an attestation report from the firm's auditor. These standards, and the internal control reports, may provide assurances when determining the adequacy of controls for publicly-traded consulting firms.

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<sup>8</sup> Performance audits are beyond the scope of this guide.