

Master Document – Audit Program

Activity Code 19404		Compliance Audit CAS 404
Version 5.9, dated June 2012		
B-1	Planning Considerations	
Purpose and Scope		
<ol style="list-style-type: none"> 1. The purpose of CAS compliance auditing is to determine if the contractor's policies, procedures, and practices used to estimate, accumulate, and report costs on Government contracts and subcontracts comply with the requirements of CAS. CAS 404 requires that, for purposes of cost measurement, contractors establish and adhere to policies with respect to capitalization of tangible assets which satisfy criteria set forth in CAS 404. It does not cover depreciation or disposition of fixed assets, which is covered by CAS 409. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 404 criteria (48 CFR 9904.404). Because of the interrelationship of the two standards and to achieve efficiency, CAS 404 and CAS 409 should be audited concurrently. 2. The scope of this audit should be limited to the last completed contractor fiscal year. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms. 3. This program is intended to provide for the proper planning, performance, and reporting on the contractor's compliance with CAS 404. The audit steps in the program should reflect a documented understanding between the auditor, the technical specialist, as applicable, and the supervisor as to the scope required to comply in an efficient and effective manner with generally accepted auditing standards and DCAA objectives. The program steps are intended as general guidance and should be tailored as determined by audit risk. 		
Other Planning Considerations		
<ol style="list-style-type: none"> 1. Before beginning any CAS compliance audit, the auditor should first determine whether the contractor is subject to the CAS coverage. If the standard is not applicable to the contractor, the audit should be cancelled. 2. Materiality (see 48 CFR 9903.305) and audit risk assessment (including Internal Control Audit Planning Summary (ICAPS) for major contractors, Survey of Contractor's Organization, Accounting System, and System of Internal Controls (ICQ) for nonmajors, and historical CAS problems) are integral parts of the planning process and should be considered in developing the extent of CAS compliance tests. 3. Once it is determined that the standard is applicable, the auditor should assess which provisions of the standard are significant to the contractor; the extent reliance may be placed on the contractor's system of internal controls to ensure compliance; and the results of other relevant audits (e.g., results of prior compliance audits, Disclosure Statement revisions, etc.). The decision to not test whether the contractor is complying with specific provisions 		

Master Document – Audit Program

of the standard should be documented.

B-1	Preliminary Steps	W/P Reference
Version 5.9, dated June 2012		
1. Research and Planning		
	a. Review the open MRD’s for guidance which may impact the audit and adjust the scope and procedures appropriately. Open MRDs can be identified using the link provided on the DCAA Intranet home page for “MRDs, AGMs, & AMGMs”	
	b. Read and become familiar with the criteria in CAS 404, CAM 8-404, and any recent Headquarters guidance not incorporated in CAM. Identify any changes in the CAS 404 standard since the last examination.	
	c. Evaluate Part V of the contractor's Disclosure Statement to become familiar with the disclosed accounting practices. Determine if the contractor's disclosed practices have changed since the last CAS 404 compliance audit. If changes have occurred, document the file and adjust the audit scope accordingly.	
	d. Determine whether the total value of the contractor’s tangible capital assets are material. Possible sources include the contractor’s financial statements, general ledger balances of plant, property and equipment, fixed asset subsidiary ledgers, depreciation schedules, CAS 414 Form CASB-CMF, and capital acquisition plans or budgets. Consider contract mix (Government vs. commercial) when determining the materiality of costs subject to this standard. Materiality should be a consideration only in determining the extent of substantive testing.	
	e. Consider whether the contractor may be expensing assets that should be capitalized. Assets may be expensed in accounts such as Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc.	
	f. Examine FAO permanent file data (i.e., relevant audit leads, MAARs Control Log, etc.) and prior relevant audit work packages to determine what data are available, what audit steps were done in the past, and the results from those steps. This will identify areas of high risk and/or areas where limited or no compliance testing is necessary. Document results.	
	g. Contact the contracting officer to ascertain any known concerns	

Master Document – Audit Program

<p>(including risk related to the contractor’s financial condition) that will impact the audit and adjust the audit scope and procedures accordingly. If information regarding the contractor’s financial condition is not available from the contracting officer, the auditor should perform the procedures addressed in CAM 2-302.1h. If during the course of the audit the auditor becomes aware of unfavorable or adverse financial conditions, they should immediately communicate their concerns to the contracting officer, and appropriately adjust the scope of audit.</p>	
<p>h. If appropriate, coordinate with the FAO technical specialist, CAC and/or regional specialist on matters of interpretation and policy.</p>	
<p>i. Electronically transmit an acknowledgement/notification to the ACO/CAFO notifying them of the commencement of the risk assessment and that the expected completion date will be provided in the formal acknowledgement/notification once the risk assessment is complete. (CAM 2-303). The acknowledgement/notification process should be within the timeframe and in accordance with the procedures in CAM 4-104.</p>	
<p>2. Entrance Conference and Preparation</p>	
<p>a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on obtaining an understanding of the contractor’s capitalization process and its internal control structure. Request the contractor to explain the following:</p>	
<p>(1) Its capitalization system and process and identify relevant written policies and procedures.</p>	
<p>(2) If considered necessary, request a “walk through” of the capitalization system.</p>	
<p>(3) Any changes, or planned changes, to policies and procedures related to CAS 404 since the last DCAA examination.</p>	
<p>(4) Any business combinations since last DCAA CAS 404 examination.</p>	
<p>(5) Any corrective actions related to previously identified noncompliances.</p>	
<p>(6) Dollar values of:</p>	
<p>(a) Self-constructed assets placed in service since prior examination;</p>	

Master Document – Audit Program

(b) Assets acquired through less than arm's length transactions; and	
(c) Asset accountability units.	
If the dollars are significant, consider separate transaction testing of these assets.	
(7) Capital budget variance analysis and explanation of significant variances. (If the capitalized amount is significantly less than the capital budget, assets may have been expensed when they should have been capitalized.)	
(8) Identify new facilities and major renovations.	
Consider separate transaction testing for initial complement of low cost equipment and betterments and improvements.	
b. If reliance is to be placed on the work of others, the file should contain the required documentation. (see CAM 4-1000).	
c. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.	
3. Risk Assessment	
a. Examine the ICQ or relevant ICAPS (whichever is applicable) to obtain information regarding accounting system adequacy, identify any known outstanding system deficiencies, and perform preliminary assessment of risk. Document results.	
b. Using the framework and the guidelines in WP B-2, obtain and document an understanding of the contractor's internal controls that are relevant to the audit. With the proper planning auditors should be able to obtain and document a major portion of this understanding during a walk-through of the contractor's assertion.	
c. Identify accounts where the contractor may be expensing assets that should be capitalized. These accounts could include Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc.	
d. Determine high-risk areas by performing the following:	
(1) Determine the dollar amounts in the various accounts.	
(2) Perform comparative analysis of the identified accounts to determine if significant changes may have occurred.	
(3) Determine provisions of the standard that are material.	
e. Hold a planning meeting with the audit team (e.g., RAM, Manager, Supervisor, Auditors) to discuss the risk of fraud and	

Master Document – Audit Program

<p>other noncompliances with applicable laws and regulations that could have a material effect on the assertion. The discussion should include relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies), relevant aspects of the contractor’s environment (e.g., the extent of incentives, pressures and opportunities to commit fraud and the propensity to rationalize misstatements), other known risk factors, and the audit team’s understanding of relevant internal controls (see W/P B-2). The team should also review and discuss the general and other relevant sections of the IG Handbook on Fraud Indicators for Contractors as well as the relevant fraud indicators in CAM Figure 4-7-3. See “Principal Sources of Fraud Indicators” below.</p> <p>Based on the team discussion and other risk assessment procedures the team should document on W/P B, Section 4 the risk factors/indicators identified and design audit procedures to meet the audit objectives and provide reasonable assurance of detecting fraud and other noncompliances with applicable laws and regulations that could have a material effect on the proposal (i.e., tailor (add/delete/modify) the audit steps). GAGAS 6.13(a)</p> <p>Communication among audit team members about the risk of material misstatement due to fraud should continue as needed throughout the audit.</p> <p>Principle Sources of Fraud Indicators:</p> <ul style="list-style-type: none"> • Handbook on Fraud Indicators for Contract Auditors, Sections I and III, (IGDH 7600.3, APO March 31, 1993) located at: http://www.dodig.mil/PUBS/igdh7600.doc. • CAM Figure 4-7-3. <p>(To access the fraud handbook, copy and paste the web address shown above into the address block in Internet Explorer.)</p>	
<p>f. From the information gathered in the preceding steps and using the materiality criteria in 48 CFR 9903.305, assess the audit risk and determine the scope of audit and extent of compliance testing to be performed.</p>	
<p>g. Update the information in the permanent files as needed (MAAR 3).</p>	

Master Document – Audit Program

C-1	Written Policy	W/P Reference
Version 5.9, dated June 2012		
1.	Determine that the contractor has a written capitalization policy (CAS 404.40(a)).	
2.	Determine that the written policy designates economic and physical characteristics as follows (CAS 404.40(b)(1):	
a.	The <u>minimum service life</u> criterion, which shall not exceed <u>2 years</u> , but which may be a shorter period.	
b.	The <u>minimum acquisition cost</u> criterion, which shall not exceed <u>\$5,000</u> , but which may be a smaller amount.	
c.	Specific characteristics which are pertinent to its capitalization policy decisions (e.g., class of asset, physical size, identifiability and controllability, the extent of integration or independence of constituent units). (CAS 404.40(b)(2))	
d.	Identification of asset accountability units to the maximum extent practical. The contractor's policy should consider (CAS 404.40(b)(3):	
	(1) Whether the component represents a significant portion of the total unit's cost (materiality);	
	(2) Whether the component is divisible from the total unit;	
	(3) Whether the component is subject to separate valuation.	
e.	Higher than \$5,000 minimum dollar limitations may be designated for original complement of low-cost equipment and for betterments and improvements if such higher limitations are reasonable in the contractor's circumstances (CAS 404.40(b)(4)).	

D-1	Acquisition Costs	W/P Reference
Version 5.9, dated June 2012		
1.	Evaluate significant items included in expense accounts, such as Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc. to determine if tangible assets which meet either the criteria in Steps 2a and 2b in W/P C-1 or the criterion in 2e in W/P C-1 are capitalized. (Audit tests in this area partially satisfy the requirements of MAAR 16.)	
2.	Evaluate significant items included in expense accounts, such as Repairs and Maintenance, Plant Rearrangement, Supplies, Equipment, etc. to determine that costs incurred subsequent to the acquisition of tangible capital assets which result in either extending the life or	

Master Document – Audit Program

<p>increasing the productivity of that asset (e.g., betterments and improvements) and which meet the contractor's established criteria for capitalization are capitalized with appropriate accounting for replaced asset accountability units. However, costs incurred for repairs and maintenance to a tangible capital asset which either restore the asset to, or maintain it at its normal or expected service life or production capacity, shall be treated as costs of the current period. (CAS 404.40(d)) (Audit tests in this area partially satisfy the requirements of MAAR 16.)</p>	
<p>3. Compare capitalized amounts of significant asset items to invoices, purchase orders, or sales contract to determine that the purchase price has been adjusted to the extent practical by premiums and extra charges paid or discounts and credits received which properly reflect an adjustment in the purchase price (CAS 404.50(a)(1)).</p>	
<p>4. Determine that the purchase price is the consideration given in exchange for an asset and is determined by cash paid or amount equivalent to what would be the cash price basis. If the amount is not available, determine that the current value of the consideration given in exchange is reasonable (e.g., market value or fair value). [Note: investment credit need not be deducted from the purchase price of a tangible capital asset in determining the acquisition cost of that asset.] Refer to CAS 404.50(a)(1)(i) and CAM 8-404.1 for details and examples.</p>	
<p>5. Determine that donated assets, which at the time of receipt meet the contractor's criteria for capitalization shall be capitalized at their fair value at that time (CAS 404.50(a)(1)(ii)).</p>	
<p>6. Determine that all costs necessary to prepare the asset for use including the cost of placing the asset in location and bringing it to a condition for normal or expected use are capitalized, such as initial inspection and testing, installation, and similar expenses where material in amount. However, materiality should be considered in deciding whether preparatory costs shall be capitalized. (CAS 404.50(a)(2)).</p>	
<p>7. Determine if the contractor capitalizes sales or use taxes or other collateral costs of acquiring tangible capital assets. If the contractor does capitalize these costs, determine if the contractor follows this practice on a consistent basis. (Note: CAS 404 permits, but does not specifically require, the capitalization of sales or use taxes or other collateral costs of acquiring tangible capital assets.)</p>	

Master Document – Audit Program

E-1	Self-Constructed Assets (MAAR 16)	W/P Reference
Version 5.9, dated June 2012		
<i>If the contractor does not have significant amount of self-constructed assets, do not perform the steps under this section</i>		
1. Determine that tangible capital assets constructed or fabricated by a contractor for its own use are capitalized at amounts which include all indirect costs properly allocable to such assets. This includes G&A expenses and cost of money when such expenses are identifiable with the constructed asset and are material in amount (CAS 404.50(b)).		
2. Determine that constructed tangible capital assets which are identical with or similar to the contractor's normal product receive an appropriate share of all indirect cost including G&A expenses and cost of money. Constructed assets which are not similar to the contractor's normal products bear only those G&A expenses specifically identifiable with the asset and material in amount.		

F-1	Less Than Arm's Length Transaction	W/P Reference
Version 5.9, dated June 2012		
1. Determine if previously used tangible capital assets that were acquired by purchase or donation were obtained in an arm's length transaction.		
2. If the acquiring transaction is not an arm's length transaction, determine if the contractor limited the capitalized acquisition cost of the asset to the capitalized cost of the asset in the hands of the owner who last acquired the asset through an arm's length transaction, reduced by depreciation charges from date of that acquisition to date of gift or sale (CAS 404.50(c)).		

G-1	Capitalization – Purchase Method	W/P Reference
Version 5.9, dated June 2012		
<i>Note: This step applies only to external business combinations.</i>		
1. Business combinations taking place prior to the applicability date of the April 15, 1996 revision to CAS 404.		
Obtain the contractor's explanations on the accounting treatment of the acquired tangible capital assets. Evaluate asset ledger/report to determine that the asset is capitalized at an amount which does not exceed the fair value at date of acquisition. Where the fair value of		

Master Document – Audit Program

<p>identifiable, acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess. Simply stated, the capitalized value can neither exceed the purchase price of the acquired company nor the fair value of the assets acquired.</p>	
<p>2. Business combinations taking place after the applicability date of the April 15, 1996 revision to CAS 404.</p>	
<p>Obtain the contractor's explanations on the accounting treatment of the acquired tangible capital assets and supporting documents and verify:</p>	
<p>a. If the assets generated either depreciation expense or cost of money charges during the most recent cost accounting period prior to a business combination, determine that the assets are capitalized by the buyer at the net book value (no step-up, no step-down) of the assets as reported by the seller at the time of the transaction (CAS 404.50(d)(1)).</p>	
<p>b. If the assets did not generate either depreciation or cost of money charges in the most recent year, determine that the assets are capitalized at an amount which does not exceed the fair value at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company, the value otherwise assignable to tangible capital assets shall be reduced by the excess (CAS 404.50(d)(2)).</p>	

H-1	Asset Accountability Units	W/P Reference
Version 5.9, dated June 2012		
1.	If the contractor uses asset accountability units, determine if the contractor identifies and separately capitalizes the assets at the time the assets are acquired (CAS 404.50(f)).	
2.	Determine if the contractor removed units from the asset accounts when they were disposed of; or if replaced, their replacements are capitalized (CAS 404.50(f)).	

A-1	Concluding Steps	W/P Reference
Version 5.9, dated June 2012		

Master Document – Audit Program

1. Summarize the results of audit.	
2. Discuss the audit results with the supervisor or the FAO technical specialist. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7). Coordinate significant or unusual issues with the CFAO, FAO Manager, and if applicable, with the CAC, CHOA, or GAC network (see CAM 8-302.4 and 8-302.6). Coordination should be both before and after discussion of results with the contractor. The CFAO should be apprised of noncompliance matters at the earliest possible date. If a noncompliance is considered immaterial, recommend to the CFAO that the contractor be to correct the noncompliance and if the noncompliance is not corrected, that the Government reserves the right to make appropriate contract adjustments should the cost impact become material (see FAR 30.602).	
3. Prepare draft audit report. If the audit scope was limited to a certain area(s) of the contractor’s accounting practices, modify the scope and opinion statements as necessary so that they clearly identify the limited areas audited.	
a. If no instances of noncompliance are found, prepare a draft audit report in accordance with CAM 10-807 (activity code 19404).	
b. If instances of noncompliances are found, open an assignment under activity code 19200, prepare an audit report in accordance with CAM 10-808, and close this 19404 compliance assignment with an MFR.	
4. If an internal control system deficiency is detected during the course of this audit, draft a flash internal control report and submit it to the contractor for comment in accordance with CAM 10-413.	
5. Conduct an exit conference with the contractor in accordance with CAM 4-304.	
6. Finalize audit report incorporating the contractor's response and audit rejoinder, if applicable.	
7. Update the permanent files. <i>Ensure that a copy of DMIS Report Number CAS 3 entitled “CAS Compliance Testing (Activity Code 194XX)” is included in the permanent file after the assignment has been closed in DMIS.</i>	