

## Master Document –Audit Program

<b>Activity Code 19420</b>		<b>Compliance Audit CAS 420</b>
<b>Version 5.8, dated June 2012</b>		
<b>B-1</b>	<b>Planning Considerations</b>	
<b>Purpose and Scope</b>		
<ol style="list-style-type: none"> <li>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 420 establishes criteria for the accumulation of IR&amp;D/B&amp;P costs and for the allocation of such costs to cost objectives. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 420 criteria (48 CFR 9904.420). FAR 31.205-18 makes CAS 420 partially applicable to all contracts even contracts which are not CAS covered or subject only to modified CAS coverage.</li> <li>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.</li> <li>3. This program is intended to provide for the proper planning, performance, and reporting on the contractor's compliance with CAS 420. The audit steps in the program should reflect a documented understanding between the auditor, the technical specialist and/or 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.</li> </ol>		
<b>Other Planning Considerations</b>		
<ol style="list-style-type: none"> <li>1. Before beginning any CAS compliance audit, the auditor should first determine the contractor is subject to the CAS coverage. If the standard is not applicable to the contractor, the audit should be cancelled.</li> <li>2. Materiality (see 48 CFR 9903.305) and audit risk assessment (including Internal Control Audit Planning Summary (ICAPS) for major contractors, 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.</li> <li>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 of reliance that 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 examinations, etc.). The decision to not test whether the contractor is complying with specific provisions of the standard should be</li> </ol>		

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documented.
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B-1	Preliminary Steps	W/P Reference
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<b>1. Research and Planning</b>		
	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 420, CAM 7-1500, 8-420, and any recent Headquarters guidance not incorporated in CAM.	
	c. Evaluate applicable parts of the contractor’s Disclosure Statement (e.g., Parts II, III, IV and VIII) to become familiar with the disclosed accounting practices. Determine if the contractor’s accounting practices have remained unchanged since the last CAS 420 compliance audit. If changes have occurred, adjust the audit scope accordingly.	
	d. Evaluate recent forward pricing or incurred cost proposals to determine whether total costs subject to CAS 420 are material. Consider contractor’s sales mix (i.e., CAS-covered Government contracts vs. non-CAS-covered and commercial). Materiality should be a consideration only in determining the extent of substantive testing.	
	e. Examine other FAO permanent file data (e.g. 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.	
	f. If appropriate, coordinate with the FAO technical specialist, CAC, and/or regional specialist on matters of interpretation and policy.	
	g. Contact the contracting officer to ascertain any known concerns (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	

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<p>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. 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><b>2. Entrance Conference</b></p>	
<p>a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on:</p>	
<p>(1) Requesting the contractor's explanation of the internal control structure as related to CAS 420.</p>	
<p>(2) Any changes since the last audit.</p>	
<p>(3) The contractor's monitoring process for classifying costs.</p>	
<p>(4) Any identified weaknesses which may have been reported and related follow-up actions.</p>	
<p>b. If reliance is to be placed on the work of others, the file should contain the required documentation (see CAM 4-1000).</p>	
<p>c. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.</p>	
<p><b>3. Risk Assessment Steps</b></p>	
<p>a. Examine the ICQ or ICAPS, whichever is applicable, to obtain information regarding accounting system adequacy, identify any known outstanding system deficiencies, and perform preliminary assessment of risk.</p>	
<p>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.</p>	

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<p>c. Hold a planning meeting with the audit team (e.g., RAM, Manager, Supervisor, Auditors) to discuss the risk of fraud and 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"> <li>• Handbook on Fraud Indicators for Contract Auditors, Sections I and III, (IGDH 7600.3, APO March 31, 1993) located at: <a href="http://www.dodig.mil/PUBS/igdh7600.doc">http://www.dodig.mil/PUBS/igdh7600.doc</a>.</li> <li>• CAM Figure 4-7-3.</li> </ul> <p>(To access the fraud handbook, copy and paste the web address shown above into the address block in Internet Explorer.)</p>	
<p>d. 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>e. Update the information in the permanent files as needed (MAAR 3)</p>	

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<b>C-1</b>	<b>Accumulation of IR&amp;D / B&amp;P Costs by Project (MAAR 16)</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Analyze job cost ledgers/reports to determine that the cost accumulation system identifies and segregates significant IR&D/B&P effort by individual project (CAS 420.40(a)). Costs of immaterial IR&D or B&P projects may be combined within each category.	
2.	Determine proper classification of IR&D/B&P effort by evaluating work authorizations, statement of work or any other similar documents. Ensure that the effort charged as IR&D or B&P is neither sponsored by a grant, nor required in performance of a contract. (CAS 420.30(a)(2) and (6)).	
3.	Evaluate detailed job cost report to determine that the costs for each IR&D/B&P project include all direct costs for IR&D/B&P projects (CAS 420.40(b) and 50(a)(1)). Direct costs are those costs, which if incurred in like circumstances for a final cost objective, would be treated as direct costs of that final cost objective.	
4.	Evaluate the most recent incurred cost submission or forward pricing rate proposal to determine if all allocable overhead costs (except business unit general and administrative (G&A) expenses) of productive activities and other indirect costs (e.g., service center costs) related to the project are applied to the direct costs based on the contractor's cost accounting practices (CAS 420.40(b) and 50(a)(2)).	
5.	Evaluate the charging practices for IR&D effort and B&P administration costs to determine that such costs are consistently treated the same in like circumstances. They are to be treated as direct charges, which, if incurred for a final cost objective, would be charged direct to contracts. Otherwise, they should be treated as indirect expenses (CAS 420.50(a) and 60(a)).	
6.	Evaluate the most recent incurred cost submission or forward pricing rate proposal to determine that the IR&D/B&P project costs exclude G&A expense (CAS 420.40(b)).	

<b>D-1</b>	<b>Accumulation of IR&amp;D / B&amp;P Costs by Pool</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Determine that IR&D/B&P costs are accumulated in a separate pool apart from the G&A pool (CAS 420.40(c)).	
2.	Determine that the IR&D/B&P pool costs consist of only:	
a.	IR&D/B&P project costs exclusive of G&A (see Step 1 above)	

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b. Allocable home office IR&D/B&P costs (see W/P E-1, Allocation to Cost Objectives, Step 3.)	
3. Determine that the contractor has consistent and equitable practices regarding the costs of preparing, submitting and supporting proposal efforts resulting from a specific requirement of an existing contract. (CAS 402.61(c))	

<b>E-1</b>	<b>Allocation to Cost Objectives (MAAR 18)</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Evaluate the objectives and/or work statements for IR&D/B&P projects and identify those projects, which benefit only the performing segment and those benefiting other segments as well.	
2.	When the project(s) benefits other segments, determine whether the project costs need to be transferred to the home office. Such project costs need not be transferred to the home office when a direct allocation to the segments is not substantially different from the allocation which would be made if they were to pass through the home office (CAS 420.50(d) and (g)).	
3.	For those projects which have been identified as benefiting more than one segment in step 2 above, determine that the projects are transferred to the home office exclusive of G&A. If the work is not a part of an IR&D/B&P project of the performing segment, then transferred costs should include G&A (CAS 420.50(d)).	
4.	For those projects which only benefit the performing segment, determine that the project costs are included in the IR&D/B&P pool and allocated on the same base used by the segment to allocate G&A expense under CAS 410 (CAS 420.50(f)(2)).	

<b>F-1</b>	<b>Inter-Segment IR&amp;D / B&amp;P Effort</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Auditors located at segments performing IR&D/B&P effort for another segment must determine whether such effort is part of an IR&D/B&P project of the performing segment.	
a.	Coordinate this determination with the CAC, home office auditor, and/or the auditor at the receiving division prior to proceeding to the next step in the audit program.	

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b. When such effort is part of the performing segment's IR&D/B&P project, determine that the project costs are transferred to the home office exclusive of the segment's G&A.	
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<b>G-1</b>	<b>Deferral of IR&amp;D / B&amp;P Costs</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Determine that all B&P costs incurred during a cost accounting period are assigned to that period only. (CAS 420.40(f)(1)).	
2.	Determine that all IR&D costs incurred during a cost accounting period are assigned to that period except as may be permitted by provisions of existing laws, regulations, and other controlling factors. (CAS 420.40(f)(2)).	

<b>H-1</b>	<b>Home Office IR&amp;D / B&amp;P Costs</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Coordination with segment auditors regarding accumulation of IR&D/B&P costs by the home office:	
a.	Coordination with the segment auditor(s) will be required to identify:	
	(1) Those IR&D/B&P projects which will benefit some segments or all segments.	
	(2) Inter-segment IR&D/B&P projects that are part of the IR&D/B&P project of the performing segment.	
b.	For those projects which have been identified as benefiting more than one segment, determine that the costs of such projects have been transferred to the home office from these segments.	
c.	Determine that the home office cost accumulation system for such costs is in sufficient detail so that the allocation to the segments can be made in accordance with the allocation requirements identified in Step 2. below.	
2.	Allocation to Segments – Evaluate the allocation(s) of home office IR&D/B&P project costs to the segments to determine that: (MAAR 18)	
a.	Direct allocations are first made for those projects that can be identified with specific segments (CAS 420.50(e)(1)). Determine if the method used to allocate the costs to more than one segment	

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is based on the beneficial or causal relationships between the projects and the segment.	
b. Those other projects remaining after the direct allocations are made to specific segments are allocated among all segments by means of the same base used to allocate the residual expenses in accordance with CAS 403 (CAS 420.50(e)(2)).	

<b>A-1</b>	<b>Concluding Steps</b>	<b>W/P Reference</b>
<b>Version 5.8, dated June 2012</b>		
1.	Summarize the results of audit.	
2.	Discuss the audit results with the supervisor and/or the FAO technical specialist. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7).	
3.	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 audit 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 notified 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).	
4.	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 19420).	
	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 19420 assignment with an MFR.	
5.	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.	
6.	Conduct an exit conference with the contractor in accordance with CAM 4-304.	
7.	Finalize audit report incorporating the contractor's response and audit	



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rejoinder, if applicable.	
8. Update the permanent files. <i>Ensure that a copy of DMIS Report No. CAS 3 entitled “CAS Compliance Testing (Activity Code 194XX)” is included in the permanent file after the assignment has been closed in DMIS.</i>	