

Master Document – Audit Program

Activity Code 10100		Incurred Cost Audit of Corporate and Home Office Shell
Version 3.2, dated June 2016		
B-1	Planning Considerations	
Audit Specific Independence Determination		
<p>Members of the audit team and internal specialists consulting on this audit must complete the Audit Specific Independence Determination (w/p 34) prior to starting any work on this assignment.</p> <p><i>(Note: Because staff is sometimes added to on-going audits, supervisors should ensure that all individuals who are directing, performing audit procedures, or reporting on this audit as a member of the audit team or who are performing as a consultant have signed this work paper. For example, an FAO may add additional auditors (e.g., FAO technical specialist) to the audit assignment or may need to consult with an internal specialist (e.g., industrial engineers, and operations research specialists) as the audit progresses.)</i></p>		
Purpose and Scope		
<p>This standard audit program assists the auditor in planning and performing the incurred cost audit of a contractor’s corporate, group, or home office (designated as home office hereafter) and/or service center allocations to determine if costs charged to auditable Government contracts are allowable, allocable, and reasonable in accordance with contract terms and applicable Government acquisition regulations. Compliance with FAR Part 31 and CAS is an inherent part of every contract audit. Auditors are expected to be knowledgeable of compliance requirements and consider them as applicable in the examination of home office incurred cost.</p> <p>If there are CAS covered contracts at segments that receive allocations from the home office(s) and/or service center(s) covered by this audit, design audit steps to support our opinion on whether the contractor’s home office allocation proposal complies with applicable CAS. The amount of testing will depend on a risk assessment considering the level of compliance testing performed in previous CAS and incurred cost audits, changes that have occurred in cost accounting practices and organizational structure, materiality of costs, findings in prior audits, etc.</p> <p>This program will serve as the controlling assignment for the audit of all home office expenses distributed to the various segments of the corporation. The program is intended to provide for the proper planning, performance, and reporting on the audit of contractor's home office allocations. The audit steps in the program should reflect a documented understanding between the auditor and supervisor as to the scope required to comply in an efficient and effective manner with auditing standards and DCAA objectives. It is expected that those portions of the audit that are covered in other work packages will be referenced at the appropriate place in this controlling assignment, including budgeted and actual hours. Audit programs in other work packages should be cross-referenced to the controlling assignment and audit step. <i>The program steps are intended as general</i></p>		

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<i>guidance and should be tailored (i.e., add/delete/modify) as determined by audit risk.</i>
Planning Considerations
Prior to commencing the audit, review guidance that may impact the audit and adjust audit scope and procedures appropriately. Guidance to review includes CAM, open MRDs, FAQ training materials, guidebooks, etc. available on the DCAA intranet.
References
○ FAR 42.7, and DFARS 242.7, Indirect Cost Rates
○ FAR 31.2, and DFARS 231.2, Contract with Commercial Organization
○ CAM 1-504, Access to Contractor Records
○ CAM 3-2S1 Supplement-Contractor Securities and Exchange Commission Reports
○ CAM 3-2S2 Supplement-Contractor Internal Revenue Service and State Taxes Reports
○ CAM 3-3S1 Special Considerations in Audits of Selected Contract Types
○ CAM 4-400, Audit Working Papers
○ CAM Chapter 6, Incurred Costs Audit Procedures
○ CAM Chapter 8 (8-403 and 8-418), Cost Accounting Standards
○ CAM 10-200, Audit Reports Format and Contents – General
○ VIPER Guidebook – Selected Areas of Cost
Definitions:
<p>The term "<i>home office</i>" is defined in CAS 403.30(a)(2) as “an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office” (CAM 8-403).</p> <p>Since this audit program deals primarily with business units that allocate costs to other business units, audit of service centers is included. Service centers are departments or other functional units which perform specific technical and/or administrative services for the benefit of other units. Their cost can be allocated partially to specific final cost objectives as direct costs and partially to other indirect cost pools, usually based on units</p>

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of output (CAM 6-606.3(a)).
The term “ <i>segment</i> ” is defined in CAS 403.30(a)(4) as “one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.”
The term “ <i>operating revenue</i> ” is defined in CAS 403.30(a)(3) as “amounts accrued or charged to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals except that it includes only the fee for management contracts under which the contractor acts essentially as an agent of the Government in the erection or operation of Government-owned facilities. It excludes incidental interest, dividends, royalty, and rental income, and proceeds from the sale of assets used in the business.” In summary, operating revenue is used to describe amounts received or receivable from contracts entered into by a company in the normal course of business.
<u>Three-Tier Allocation</u> - CAS 403 distinguishes three broad types of home office expenses. The standard recognizes that some home office expenses incurred for specific segments can be assigned directly (Tier 1). Other expenses, not incurred for specific segments, have a clear relationship (i.e., measurable with reasonable objectivity) to two or more segments (Tier 2). Lastly, the standard recognizes a third type of home office expense (i.e., residual) which possesses no readily measurable relationship to segments (Tier 3). Consistent with this concept of home office expenses, the standard requires that expenses incurred for specific segments are to be allocated directly to those segments to the maximum extent practical (Tier 1). Those expenses not directly allocable, but possessing an objective measurable relationship to segments, should be grouped in logical and homogeneous expense pools and distributed on allocation bases reflecting the relationship of the expenses to the benefiting segments (Tier 2).
<u>Residual Expense Allocation (Tier 3)</u> Residual expenses - those incurred for managing the organization as a whole - have no readily measurable relationship to segments. The allocation of these expenses will use one of the two methods: (1) an allocation by means of a base representative of the total activity of the segments, if the total residual expenses do not meet certain threshold requirements; or (2) an allocation by a three factor formula if the residual expenses exceed a specified percentage of total company operating revenue (as defined in CAS 403.40(c)(2). When a particular segment receives significantly more or less benefit from the residual expenses than would be reflected by the allocation (1) or (2) above, a special allocation can be used in conjunction with methods (1) and (2).

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B-1	Preliminary Steps	W/P Reference
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ADEQUACY		
1. Analysis of the Contractor’s Home Office Allocations Proposal		
a. Review the results of the adequacy review of the home office incurred cost proposal and note any audit leads requiring further consideration. Document the impact on the audit.		
b. Determine whether the certified home office incurred cost proposal provides for the reconciliation by account (1) expenses allocated directly to segments or final cost objectives, (2) indirect expense pools and allocation bases and (3) residual expenses, to the contractor’s books and records (MAARs 2 and 14 (CAM 6-610)). If the certified home office incurred cost proposal does not include the contractor’s reconciliations, discuss with the contractor at the entrance conference and request the contractor provide the reconciliation of expenses to its books and records.		
c. Determine which method(s) the home office incurred cost proposal uses for allocating residual expenses to segments, as defined in CAS 403.40(c). Document the results and use the appropriate audit steps in Section H-01.		
d. MAAR 19: Verify and document the mathematical accuracy of the contractor's computations including the calculation of the three factor formula (if applicable) (CAM 6-611.1a). Generally, the validation of the segment information used in the formula should be done via an assist audit with the cognizant auditor at the segment level (CAS 403.50(c)(1).		
COMMUNICATION/COORDINATION WITH OTHERS		
2. Contact the contracting officer to notify them of the commencement of audit. Discuss any significant concerns or other information that the contracting officer may have relevant to the audit (e.g. timeframes, significant prior findings, etc.) that will impact the audit and adjust the audit scope and procedures accordingly.		
3. Coordinate with the cognizant auditor(s) at all home office(s) and segment(s) on the reconciliation of incurred cost proposals, assist audit request(s), timing of the audits, and expected completion dates. Incorporate any agreed to dates into the milestone plan.		

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<p>a. If indirect rates are settled at any segment(s), with material dollars, reconsider the risk before performing the home office audit and exclude dollars from the ADV calculation.</p>	
<p>b. If indirect rates are settled at a segment with material dollars before the corporate or intermediate home office audit is completed, elevate to regional office. The ACO should be notified that it should not negotiate final rates on segments before the corporate or intermediate home office audit is completed.</p>	
<p>4. Assess the need for any assist audits. Depending on materiality, assist audit requests can range from full scope audits to procedures using the one audit approach (e.g., verification of segments information used in the three factor formula and reconciliation of home office allocations and/or billings).</p>	
<p>a. If the components of allocation bases are not under the cognizance of the FAO, request the applicable assistance to verify the main component of the allocation bases.</p>	
<p>b. Determine if the contractor’s proposal identifies significant allocations from segments, other home offices, or service centers and explains how the costs coming in from other segments can be identified in the accounting records. If incoming costs are not clearly identified in the proposal and/or accounting records, request the contractor to explain its processes for receiving, charging, and recording these costs as directly allocated, in logical and homogeneous pools, or as residual expenses. Based on the understanding of the processes, tailor the appropriate assist audit requests and detailed steps to ensure appropriate audit coverage.</p>	
<p>c. If the contractor has a Washington area office (CAM 6-806) where costs are material and/or other risk factors exist, gain an understanding of the contractor’s process for identifying and excluding unallowable costs and directly associated unallowable costs for lobbying and political activities. Based on the understanding and the significance of costs include steps in the fieldwork to ensure appropriate coverage. If it is determined that interviews of the employees in the Washington area is necessary, contact the field audit office that have cognizance of the location (i.e., zip code) in which the contractor’s employee is located.</p>	
<p>d. Draft assist audit requests and/or submit an audit approach plan submit to supervisory auditor for approval (if applicable).</p>	
<p>e. Document all assist audit requests on WP B-03.</p>	
<p>AUDITABLE DOLLAR VOLUME (ADV)</p>	
<p>5. Calculate the Auditable Dollar Volume (ADV) in the home office allocation(s). The estimates should be reasonable approximations of</p>	

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<p>the impact on flexibly priced Government contracts at the segments that receive an allocation from the home office. (Note: The guidance for computing ADV is available in the DMIS User Guide or Computation of Dollars Audited Cost Savings W/P 02.)</p>	
<p>COMMUNICATING THE ENGAGEMENT</p>	
<p>6. Hold an initial planning meeting with your supervisor (or if appropriate, the audit team) to discuss the materiality of the audit based on results of determination of ADV and discuss the audit scope required to meet auditing standards taking into consideration materiality of the audit assignment. Also, include discussion of the milestone plan.</p>	
<p>PERMANENT FILES</p>	
<p>7. Review permanent files (MAAR 3) and readily available information for indicators of risk that may impact the scope of audit. For each of the steps below, document the impact on audit objectives and modify fieldwork audit procedures, accordingly.</p>	
<p>a. Review audit leads (e.g., voluntary disclosures and Form 1s), the CAS disclosure statement for the year under audit, multi-segment contractor responsibility matrix (if applicable), and prior related audits (e.g., CAS audits, and business system) to determine what audit steps were performed and the results of audits to identify key areas to be considered in establishing the audit scope.</p>	
<p>b. Determine if the contractor's accounting practices have changed (48 CFR 9903.302-2 and FAR 52.230-6) since the last applicable CAS compliance audits. Evaluate changes in procedures and practices, contractor structure, materiality, etc. for charging costs as directly allocated, via special allocation, or as residual for consistency with generally accepted accounting principles (GAAP), applicable cost principles, CAS, and disclosed practices (similar to MAAR 7). Be alert for undisclosed changes during the audit. If changes have occurred, document the file and adjust the audit scope accordingly.</p>	
<p>c. Determine whether the contractor used its fiscal year as its cost accounting period. Review the prior year incurred cost submission to determine whether the contractor changed its fiscal year (CAS 406).</p>	
<p>d. Obtain current organization charts and compare to the organization charts contained in the permanent file to identify any changes in organizational structure requiring follow-up and consideration in audit scope.</p>	
<p>e. Review any Advance Agreements affecting costs in the fiscal year (FY) being reviewed.</p>	

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<p>f. Review permanent file to determine if previous audits included findings and recommendations that impact the subject matter under audit (GAGAS 5.06). If there were findings, auditors should document this information in the risk assessment and perform the following procedures:</p> <ol style="list-style-type: none">1) During the entrance conference, ask contractor management if corrective actions were taken to address findings and recommendations reported in previous DCAA audits (e.g., questioned costs, business system deficiencies, CAS audits) that are relevant to the subject matter of audit. If yes, have contractor explain corrective actions taken and determine if additional audit procedures should be included in the fieldwork to test the corrective actions.2) Document the results of the inquiry and the impact of the corrective actions to the subject matter under audit. (Note: The purpose of this question is to follow up with contractor on relevant prior DCAA audit findings that could have a material effect on the subject matter of audit.)	
<p>g. Review permanent file to determine if the contractor has previously provided other studies or audits (e.g., summary listing of internal audits or external audit reports) that directly relate to the subject matter under audit (GAGAS 5.06). If there are no other studies or audits, document that information in the work papers and perform the procedures below. (If you do not perform the following procedures, you must document your justification for the departure.)</p> <ol style="list-style-type: none">1) During the entrance conference:<ul style="list-style-type: none">• Ask contractor management if internal audits were performed. If yes, request contractor provide a summary listing of the internal audits that would assist us in understanding and evaluating the efficacy of the internal controls relevant to the subject matter of the audit.• Ask contractor management if other types of audits or studies were performed by other than DCAA (e.g., other Government audit agencies, consultants, Independent Public Accountants, etc.) that would impact the subject matter under audit. If yes, have contractor explain what type of audits or studies were performed, if there were any related findings or recommendations, and any contractor corrective actions taken as a result.2) If the review of the perm file or the contractor identifies relevant internal audits:<ul style="list-style-type: none">• Determine if access to these reports is necessary to	

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<p>complete the evaluation of the relevant internal controls to support the risk assessment or audit procedures related to the subject matter of the audit. There must be a nexus between the internal audit reports and the scope of this specific assignment.</p> <ul style="list-style-type: none"> • Document the results of the determination in writing. • If assignment is at a major contractor location, coordinate with the CAC or FAO point of contact (POC) for internal audit reports to request the contractor provide access to the reports. • If assignment is at a non-major contractor and the FAO does not have a designated POC, the auditor should request the contractor provide access to the internal audit reports. • The request, issued by the CAC, FAO POC or auditor, should include information on how the internal audit report is relevant to the DCAA audit. Place a copy of the request in the assignment administrative work papers. <p>3) If the review of the perm file or the contractor identifies relevant other audits or studies:</p> <ul style="list-style-type: none"> • Obtain publicly available information for the relevant other Government agency audits (e.g. websites for DoD IG or other IGs, service audit agencies, etc.). • Make appropriate adjustments to your risk assessment and planned procedures based on reported findings. <p>4) Document the results of the inquiries including the response received from contractor’s for any request for access to internal audit reports. (If access was not granted this should include the contractor’s rationale or justification for not granting access).</p> <p>5) Review the results and determine if additional audit procedures are needed to address any identified risk. (Note: The purpose of this question is to discover any new audit leads that could affect the scope of current audit.)</p>	
<p>8. MAAR 6. Consider the impact of real-time MAAR 6 on audit scope. If labor costs are significant, and no real-time testing was performed or real-time testing was not sufficient, design alternate procedures to test for existence and allocability. [Reminder: the audit team should identify the level of alternate procedures required to opine on the labor costs based on identified risk of the cost element.]</p>	
<p>9. Review applicable board of directors' minutes, audit committee minutes for the year(s) being audited, and other sources (e.g., company website, company newsletters, etc.) for potential audit leads</p>	

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requiring follow-up and consideration in audit scope. (CAM 3-204.16(c), and 6-608.2(b)).	
ANALYTICAL PROCEDURES	
10. MAAR 15: Indirect Cost Comparison with Prior Years and Budgets.	
a. Compare base and pool totals to prior year and budgetary amounts. Identify significant variances which may require further audit analysis and/or explanation.	
b. Determine if the expense pools structure used to accumulate actual costs is consistent with the CAS disclosure statement applicable to the year under audit and indirect rate structure used to prepare the home office forward pricing proposal(s) for the same year (CAS 403/FAR 31.203). Include or tailor audit steps to address any noted inconsistencies.	
c. Depending on risk and materiality factors, compare final indirect accounts within pools to prior year and budgeted amounts to identify changes in accounting practices, reclassification of costs, critical and sensitive accounts (e.g., lobbying, consulting), new accounts, and accounts with large variances that require further audit analysis and/or explanation.	
d. Perform an analysis to identify accounts not previously tested. Pay particular attention to the expense types which may not be applicable to the business as a whole. Consider the results in the planned audit scope (G-01, Step 1).	
e. Obtain a list of all transactions for sensitive accounts, new accounts, and accounts with large variances from performing steps a. and c. above. Scan transactions for selected accounts to identify leads such as suspect vendors, related party transactions, high dollar amounts and other transactions that appear sensitive or unusual. Consider these in planning for detailed transaction testing. Be alert for unallowable costs that may not be readily visible. Tailor the detailed audit steps, if necessary, to address any risks identified.	
11. MAAR 8: Comparative Analysis-Sensitive Labor Account (CAM 6-404.6b(4)). Perform a comparative analysis of sensitive labor accounts to identify any sensitive labor charges that vary significantly from prior periods and/or budgetary estimates.	
12. If not provided in the incurred cost proposal, obtain a schedule of executive compensation costs from the contractor. Evaluate the schedule and compare the claimed compensation to prior years. Determine if there are significant changes from prior years and/or if claimed executive compensation is over the regulatory compensation ceiling (CAM 6-414.8). Document the results of your analysis.	

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<p>13. Gain an understanding of the contractor’s process in setting the compensation package (executive and non-executive) and ensuring that the aggregate of each element of the total compensation package complies with the allowability and reasonableness requirements of FAR 31.205-6. Based on this understanding and identified risk, develop steps to test the reasonableness of the contractor’s compensation costs. Coordinate with segment auditors to plan adequate audit coverage and avoid duplication of effort. Request assistance in determining reasonableness as necessary.</p>	
<p>DETECTING AND DOCUMENTING FRAUD RISK</p>	
<p>14. During the entrance conference, or other appropriate meeting, make inquiries of contractor management regarding knowledge of any fraud or suspected fraud affecting the fiscal years’ incurred cost under audit, managements awareness of allegations of fraud or suspected fraud affecting the incurred cost audit(s), and management’s understanding about the risks of fraud relevant to the incurred costs under audit. Note: This discussion and any data submitted should be documented in the working papers.</p>	
<p>15. Hold a planning meeting with the audit team (at a minimum, Supervisor and Auditor) to discuss the risk assessment. As part of the planning meeting, the audit team should discuss and identify potential noncompliances, due to error or fraud that could materially affect the subject matter.</p> <p>The discussion should include</p> <ul style="list-style-type: none"> • relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies) • relevant aspects of the contractor and its environment • risk of material noncompliance due to fraud (e.g., the extent of incentives, pressures and opportunities to commit and conceal fraud, and the propensity to rationalize misstatements) • other known risk factors • the audit team’s understanding of relevant internal controls. • Inquiries to the contractor regarding its fraud management plans and controls <p>Document fraud risk factors/indicators (see - Sources of Fraud Risk Factors below) that are present and could materially affect the subject matter. Also document the inquiry on contractor’s fraud management controls/plans. If fraud risk factors are present, document specific audit procedures designed to address the increased risk of material</p>	

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<p>noncompliance due to fraud.</p> <p>Communication among audit team members about the risk of material misstatement due to error or fraud should continue as needed throughout the audit.</p> <p>Sources of Fraud Indicators:</p> <ul style="list-style-type: none"> • GAGAS Appendix Section A.10 – Examples of Indicators of Fraud Risk (http://gao.gov/products/GAO-12-331G) • AU-C 240.A75 (Appendix A)- Consideration of Fraud in a Financial Statement Audit, Examples of Fraud Risk Factors (http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00240.pdf) • DoDIG’s Contract Audit Fraud Scenarios and Resources website (http://www.dodig.mil/resources/fraud/resources.html) <p>(To access the Sources of Fraud Indicators, copy and paste the web address shown above into the address block in Internet Explorer.)</p>	
INTERNAL CONTROLS	
<p>16. Coordinate with the contractor and obtain a walk-through of the incurred cost proposal. Obtain and document an understanding of the contractor’s home office allocations and its processes for developing the proposal using the framework on WP B-2. Obtain and document an understanding of the underlying processes related to those specific incurred cost areas (e.g., the basis of costs and from where the numbers/amounts are derived). A major portion of this understanding may be obtained during a walk-through of the contractor’s proposal.</p>	
<p>17. Review and document the auditor’s assessment of control risk for the control objectives related to the audit of home office allocations. Review contractor policies and procedures, prior system audits, deficiencies reports, and real time audits (MAARs 6, if applicable) to gather the data needed to assess control risk. Based on the auditor’s assessment of control risk, the auditor should design audit procedures to address the risk factors/indicators identified to provide reasonable assurance of detecting material errors or misstatements, and other noncompliances with applicable laws and regulations that could have a material effect on the home office proposal (GAGAS 5.07).</p>	
<p>18. Documenting Reliance on Computerized Information Systems –</p>	

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<p>Determine if systems’ testing and documentation were performed for the year under audit. If not, develop, document, and reference in B-2 the procedures/tests in this audit that will support reliance on the computer-generated evidence in conducting substantive testing.</p>	
<p>19. Scanning Controls. Determine the reliance of scanned documents for the contractor’s fiscal year being audited. If not performed in another assignment, request the contractor to provide a demonstration/walk-through to obtain an understanding of the system and control activities over the functional elements that make up the source document imaging process. If necessary, include in audit procedures to test a sample of images to original documentation as part of audit scope.</p>	
<p>20. Testing to Payment. Obtain an understanding of the contractor’s policies, procedures, and processes, including internal controls, applicable to the fiscal year under audit for ensuring timely payment of costs. Consider the contractor’s financial statements and aging of accounts payable, financial condition, or other considerations that identify risk the contractor is delinquent in paying costs in the ordinary course of business. Assess the risk of the contractor being materially non-compliant (i.e., delinquent in payment of cost).</p> <ul style="list-style-type: none"> a. Consider the results of testing to payments performed during the incurred cost fiscal year in other assignments (e.g., paid voucher, accounting/billing system). Document the reliance on any specific audit work previously performed. b. Based on your risk assessment, design audit procedures to ensure the contractor’s compliance with FAR 52.216-7(b)(1). <ul style="list-style-type: none"> i. If the risk of non-payment is low, perform a judgmental selection or statistical sample of all payments (i.e., all non-labor expense accounts) to source documents (e.g., cancelled checks, electronic funds transfers, bank statements, or other evidence of payment). ii. If the risk of non-payment is high, establish payment as a criterion when testing for allowability. 	
<p>OTHER RISK PROCEDURES TO CONSIDER BASED ON MATERIALITY, SIGNIFICANCE, AND APPLICABILITY (<i>Discuss with your supervisor and obtain approval prior to performing these steps.</i>)</p>	
<p>21. Determine the significance of (unclassified) Independent Research and Development (IR&D) cost incurred on or after January 30, 2012 that the contractor proposes to allocate to unsettled flexibly-priced contracts awarded on or after January 30, 2012. These costs are subject to the DFARS 231.205-18(c)(iii)(C) requirement that certain contractors report IR&D information to the Defense Technical Information Center (DTIC) in order to claim the costs as allowable.</p>	

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<p>If significant, determine if the contractor is a "major" contractor as defined in DFARS 231.205-18(a) that is required to comply with the allowability provisions in DFARS 231.205-18(c), and assess the risk of material noncompliance, by accomplishing the following:</p> <ul style="list-style-type: none"> a. During the walk-through, request the contractor to provide rationale for a classification other than "major" as defined in DFARS 231.205-18(a). Coordinate with auditors at the segments to ensure consistency. b. For contractors defined as “major” obtain: <ul style="list-style-type: none"> i. policies and procedures to report IR&D projects to the DTIC database as required by DFARS 231.205-18(c)(iii)(C), and ii. access to contractor's input provided to the DTIC database pertaining to IR&D project costs included in the contractor’s incurred cost proposal. c. Based on the information obtained, for “major” contractors as defined in DFARS 231.205-18(a) with significant IR&D, assess whether to include audit steps to test that IR&D meets the allowability criteria in DFARS 231.205-18(c). If the auditor selects IR&D for testing, review guidance in MRD 14-PAC-005(R) dated April 24, 2014. 	
<p>22. Evaluate the Contractor Insurance and Pension Review (CIPR), the Report on Contractor Pension and Post Retirement Benefit (PRB) Plans, results of CAS related audits and other readily available information to identify potential risk factors or any significant events that may result in a material impact on Government contract costs. Note: DCAA will perform independent CIPR in coordination with DCMA.</p>	
<ul style="list-style-type: none"> a. Obtain from the contractor claimed insurance and pension costs by types and assess materiality. 	
<ul style="list-style-type: none"> b. Evaluate the results of prior related audits to identify significant deficiencies or noncompliances in the Contractor Insurance and Pension program that affect claimed insurance and pension costs. 	
<ul style="list-style-type: none"> c. For contractors with qualified defined benefit pension plans, review the Report on Contractor Pension and Post Retirement Benefit (PRB) Plans required in DCAA Instruction 7600.3, and IRS Form 5500, Schedules R (line 9) or Schedule SB (lines 24 and 25) to identify any significant events (e. g., a plan amendment, a change in actuarial assumptions, a segment closing, pension plan 	

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<p>termination, curtailment of benefits, etc.) that would require a Contractor Insurance and Pension Review (CIPR) based on the risk assessment. If an audit is warranted, coordinate with the DCMA CIPR team and supervisory auditor, to audit pension costs using applicable standard audit programs for CAS 412 and 413.</p>	
<p>d. Document the results of your analysis and its impact on the scope of audit. Discuss with supervisory auditor.</p>	
<p>23. MAAR 4: Review corporate financial statements (including notes), tax returns (CAM 3-2S2), and SEC filings (CAM 3-2S1) as appropriate for significant or unusual items (e.g., legal proceedings, foreign tax credits, joint venture, teaming agreement, etc.) to gain additional insight into the type and nature of the contracting entity that may impact audit objective. Review Management’s Report on Internal Control over Financial Reporting that accompanies the financial statements. Document the potential impact on the scope of audit.</p>	
<p>24. Review the schedule of facilities, layouts, and floor space utilization for the FY under audit. Make inquiries and/or observations to determine if any facilities were/are idle, owned by a related company, or leased to other entities. Consider the results in the planned audit scope.</p>	
<p>25. Health Care Costs. As part of the examination of health care costs, review policies and procedures and request the contractor to demonstrate its procedures for ensuring only costs related to “eligible employees and dependents” have been claimed. Based on the understanding of the contractor’s processes and overall risk, design audit steps (or set up a separate audit package) to verify the contractor included only health insurance premiums and claims for “eligible employee and eligible dependents” (FAR 31.201-3 and 31.205-6(m)). Document the result of your examination on W/P G.</p>	
<p>SUMMARY OF RISK ASSESSMENT AND SCOPE OF AUDIT</p>	
<p>26. Conduct an entrance conference:</p>	
<p>a. Coordinate and communicate entrance conference details with customer(s) and contractor.</p>	
<p>b. Confirm the team’s understanding of the contractor’s home office proposal and supporting data. Discuss the availability of required data and personnel necessary to timely support the audit. The entrance conference should also include any additional walkthroughs/clarifications of the proposal with detailed discussions on allocation processes and specific cost accounts. Examples of discussion points could include direct allocation, management fees, other allocation approaches, home office expenses grouped in logical and homogeneous expense pools,</p>	

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central payments or accruals, IR&D costs, state and local income taxes, franchise taxes, treatment for refunds of state taxes, residual expense allocation, special allocation, Government contracts performed by the home office, idle facilities, change in accounting practice, etc.	
c. Follow up with contractor management on corrective actions that address previous DCAA audit findings and recommendations	
d. Follow up with contractor management regarding other studies or audits that impact the subject matter under audit	
27. Supervisory Approval	
a. Review and discuss with your supervisor (or if appropriate, the audit team) the overall results of the risk assessment and the audit scope planned, including the detailed audit steps. Make any further adjustments to the audit program steps necessary to obtain sufficient evidence to provide a reasonable basis for the conclusion that will be expressed in the audit report.	
b. Obtain and document supervisory approval of the risk assessment and the planned scope of examination for each audit area documented in W/P B and -1 W/Ps.	
28. Electronically transmit an acknowledgement/notification letter to the appropriate Contracting Officer and the Contractor notifying them of the commencement of the audit and expected completion date. The acknowledgement/notification letter should be issued within the timeframe and in accordance with the procedures in CAM 4-104.	

C-1	Reconciliation to Records	W/P Reference
Version 3.2, dated June 2016		
1.	MAAR 2: Cost Analysis and Reconciliation to Books. Verify the contractor’s reconciliation of costs allocated to segments, other home offices, and service centers to the contractor's accounting records. Follow-up and obtain explanations on significant differences (CAM 6-610.1). (Note: The costs allocated to segments should include costs transferred “to” the home office “from” segments before being reallocated to benefiting segments or before calculation of the three factor formula (if applicable).)	
2.	MAAR 14: Pools/Bases Reconciliation to Books. Verify claimed expense pools and allocation bases to accounting records to determine that the claimed amounts reconcile to the contractor’s official books and records. If the base includes costs or data from business units other than this home office, incorporate the results of requested assist	

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audits or use of the one audit approach. Follow-up on significant differences.	
3. MAAR 9: Payroll/Labor Distribution Reconciliation. Reconcile total payroll dollars with total of related labor cost in the general ledger and labor distribution records. Review the contractor’s reconciliation of total salaries and wages to payroll tax returns (IRS Form 941) (schedule L, reconciliation of total payroll per IRS form 941 to total labor cost distribution). The home office level should perform the MAAR 9 (if applicable).	
4. Reconcile voluntary deletions to the books and records and ensure all voluntary deleted account balances are identified and accounted for as unclaimed in the contractor’s proposal, including directly associated unallowable costs in accordance with FAR 31.201-6. Identify any voluntary deletions for consideration in planning transaction testing.	
5. Summarize the results and note whether any areas require further analysis during detailed testing.	

D-01	Labor	W/P Reference
Version 3.2, dated June 2016		
1.	MAAR 6: Contractor Labor Audit (CAM 6-404). Review and incorporate the results of the MAAR 6 (labor floor check and interview) audit. Based on the results of the risk assessment, perform additional labor testing procedures, as required, to opine on the allowability, allocability, and reasonableness of incurred labor costs. Determine if testing to payment is necessary.	
2.	MAAR 8: Comparative Analysis – Sensitive Labor Accounts. Evaluate any significant changes resulting from comparative analysis of sensitive labor accounts for possible misclassification.	
3.	MAAR 9: Payroll/Labor Distribution Testing (CAM 6-406.2a (6)). Test quarterly taxes to evidence of payment (e.g., contractor bank statements, electronic funds transfer, or third party payroll processor records). Ensure total taxes owed were paid.	
4.	MAAR 10: Adjusting Entries and Exception Reports (CAM 6-404.6b(6)). Evaluate adjusting journal entries and exception reports for labor. Identify adjustments requiring further audit examination and explanation. Based on risk, test labor adjusting entries. Normally, labor at a home office is indirect. If direct labor is charged, include direct labor transactions in the sample for testing. Be alert to	

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D-01	Labor	W/P Reference
	situations where labor costs are being transferred without supporting timecards and/or documentation. Seek explanations for any abnormal adjusting entries or corrections.	
5.	Executive Compensation:	
a.	Incorporate the results of assist audits on executive compensation, if applicable.	
b.	Verify that executive compensation costs are calculated consistently with the contractor’s policy and procedures. Trace the executive compensation costs to the appropriate expense accounts to ensure that all the executive compensation is being evaluated for reasonableness. Review any contractor market pricing documentation whether performed internally or by an outside consultant for compliance with FAR 31.205-6. If necessary, coordinate with Regional Special Programs Office or MAR Compensation Team to review results of contractor market pricing.	
c.	Perform sufficient steps to verify that all allocable executive compensation in excess of the statutory compensation ceilings (see CAM 6-414) has either been appropriately: (i) excluded from the contractor's incurred cost proposal, or (ii) identified as expressly unallowable costs and questioned in the audit report.	
d.	Determine whether the contractor has claimed costs for the same executives in multiple segments.	
6.	Reasonableness of Non-Executive Compensation (including bonuses and awards): If indicated by the risk assessment, test the reasonableness of other than executive compensation. Both executive and non-executive compensation are periodically the subject of reviews of external equity (i.e. the process of comparing compensation to market compensation). Review the contractor’s evaluation of external equity for compliance with policies, procedures and FAR 31.205-6. Consider coordinating with the Regional Special Programs Office or the Mid-Atlantic Compensation Team for guidance and assistance. See CAM 6-413.	
7.	Incorporate the results of labor related assist audits, if applicable.	
8.	Perform additional steps as necessary to verify that directly associated compensation costs were excluded/questioned (FAR 31.201-6(a)). Verify voluntary deletions are properly allocated to segments.	
9.	Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.	

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E-01	MAAR 18 Allocation Bases for Expense Pools/Service Centers	W/P Reference
Version 3.2, dated June 2016		
1. Review and determine the allocation bases and the functions of the intermediate and final indirect pools described in the disclosure statement and/or policies and procedures in effect for the year under audit.		
2. MAAR 18: Indirect Allocation Bases.		
a. Based on the risk assessment, evaluate the contractor’s indirect cost allocation base(s) and functions of the pool(s) identified in Step 1 above to verify that the actual base(s) and pool(s) properly: (1) reflect(s) the appropriate cost accounting period (CAS 406); and (2) groups actual costs in logical and homogeneous expense pools that allocates indirect cost to final cost objectives commensurate with the benefits received (CAM 6-606 and 6-610.2; CAS 403, 418, and 420, if applicable).		
b. Compare the composition of the pool and bases in the incurred cost proposal:		
(1) with the preceding year’s incurred cost proposal. If composition of this year’s pool(s) and/or base(s) is different from the composition of last year’s pool(s) and/or base(s) and there is no corresponding approved cost accounting practice change, compute the impact of the differences and determine the reasonableness and equity of the results.		
(2) to the forward pricing rate proposal(s) for the same year and disclosure statement applicable to the year under audit (CAS 401).		
(3) If the composition of the pools and/or bases is different in (1) and (2), prepare noncompliance reports with the disclosed practices and/or applicable CAS.		
3. If components of the base are under the cognizance of the FAO, perform the following steps:		
a. Examine the components of the base to ensure all applicable activities that benefit from the pool are included in the base.		
b. If an allocation base is not based on costs, like sales, reconcile the amounts that makeup the base to appropriate source documentation such as annual report, audited financial statements, subsidiary journals, or similar records.		
4. Summarize the results including the conclusions, basis of proposed		

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E-01	MAAR 18 Allocation Bases for Expense Pools/Service Centers	W/P Reference
cost, and audit evaluation.		

F-01	Directly Allocated Cost	W/P Reference
Version 3.2, dated June 2016		
1. Review the contractor’s disclosure statement and/or direct allocation policies and practices to determine if they require direct allocation to segments to the maximum extent practical (CAS 403.40(a)(1)).		
2. Evaluate detailed breakdown of directly allocated costs using analytical procedures (such as nomenclature review, account analysis and comparative analysis of segments’ costs) to determine if expenses for specific segments are allocated directly to those segments to the maximum extent practical (CAS 403.40(a)(1)).		
3. Based on the risk assessment, test directly allocated cost to verify that costs claimed are allowable, allocable, reasonable, consistently charged in accordance with applicable GAAP, cost principles, and CAS (similar to MAAR 7), and in accordance with the agreement between home office and segments. Determine if testing to payment is necessary. At a minimum:		
a. Determine if (1) approvals were made at adequate levels; (2) materials/services were needed for the segment/contract; (3) prices and units on invoices match prices and units on the purchase orders and/or consultant and legal agreement; (4) goods or services were received; and (5) cost were properly recorded. Coordinate with the auditor at the segment that receives the allocation, if necessary.		
b. Determine whether there is a causal or beneficial relationship between the directly allocated expense and the receiving business unit.		
4. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.		

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G-01	Expense and Residual Pools	W/P Reference
Version 3.2, dated June 2016		
<i>Note – Consider the use of statistical sampling techniques, if appropriate.</i>		
1. Perform MAAR 16: Indirect Account Analysis (CAM 6-608.2c).		
a. If not already performed as part of risk assessment, review the accounts in the expense pools and determine the types of costs (Allocation costs that originated at the home office, or Service Center) that are claimed.		
b. Perform transaction testing on accounts selected through MAAR 15 performed in B-01, to obtain sufficient evidence to support an opinion on allowability (FAR 31.201-6 and CAS 405), allocability (FAR 31.201-4), and reasonableness (FAR 31.201-3) of these costs. Verify these costs are consistently charged in accordance with applicable GAAP, cost principles, CAS, and contractor’s disclosed practices (similar to MAAR 7). Consider establishing separate working paper packages to audit specific areas of cost that are not covered in this program, such as bonuses/awards, consultant, cost of money, deferred compensation, depreciation, employee stock option plan, facility, fringe, information system, insurance, legal, pensions, post-retirement benefits, profit sharing, restructuring costs and taxes. If applicable, utilize standard programs that have been developed for pensions (Activity Code 19412 & 19413), insurance (19416), taxes, deferred compensation, and consulting and legal costs (10160) located under Audit Tools/Audit Programs, Reports, OAGs on the DCAA Intranet.		
2. Service Centers		
a. Compare the claimed practices for accumulating service center costs to disclosed practices for the fiscal year under audit.		
b. Verify that the contractor performs a ‘true-up’ at year end where it adjusts its billed rates to the actual rates (if applicable).		
c. Perform transaction testing on the service center costs to determine allowability (FAR 31.201-6), allocability (FAR 31.201-4), and reasonableness (FAR 31.201-3), and compliance with applicable CAS and disclosed practices. Determine if testing to payment is necessary.		
d. Incorporate the results of requested assist audits, if applicable.		
3. MAAR 5: General Ledger, Trial Balance, Income and/or Credit Adjustments (CAM 6-608.2d(5)). Document your understanding of		

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G-01	Expense and Residual Pools	W/P Reference
	<p>the types of income and credits occurring at this contractor, and your understanding of the contractor's methods for accounting for income and credits. Analyze the contractor's general ledger, trial balance, and entries to profit accounts and other income accounts to identify any credits or income that have not been accounted for which the Government may be entitled to a credit. (e.g. purchase discounts, scrap sales, rental income, excessive company reserves, insurance, unused or unpaid vacation, severance pay and early retirement, and state tax rebates and refunds, etc.) Identify adjustments requiring follow-up.</p>	
4.	<p>MAAR 10: Adjusting Entries and Exception Reports. Evaluate adjusting journal entries and exception reports for indirect expenses. Identify significant and/or sensitive adjustments requiring further analysis and explanation (e.g. journal entries reclassifying direct to indirect costs).</p>	
5.	<p><i>Pensions [Use this section if a separate audit of pensions is not performed as discussed on Step 1b above.]</i></p>	
a.	<p>Pension costs are audited by the FAO cognizant of the contractor location where the plans are administered and the costs are incurred. For multi-segment contractors, this will generally be the corporate home office. Therefore, develop audit steps considering the FAR and CAS requirements and review the pension information reported on IRS Forms 5500, 5500-SF (for small businesses) and Schedules SB, R, H and I as appropriate. Identify any CAS 413.50(c)(12) events and pension plan costs or credits that may result from a segment closing or curtailed or terminated pension plan..</p>	
b.	<p>If no pension costs are incurred for the year, the following steps are mandatory for defined benefit pension plans:</p>	
(1)	<p>Evaluate the Trustee Report and obtain an explanation for any significant withdrawals of pension assets. Perform additional audit steps as needed to ensure that Government contributed pension assets are protected. Note asset and liability transfers reported on IRS Form 5500, "Financial Information," Schedule H or Schedule I (for small businesses), line 5b.</p>	
(2)	<p>If the contractor's practice is to calculate pension costs by segment:</p>	
a.	<p>Verify that the CAS 412.50(b)(7) Pension Harmonization Rule has been applied at the segment level (<i>the change in the standard is effective as of February 27, 2012 and is applicable for costs accounting periods after June 20,</i></p>	

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G-01	Expense and Residual Pools	W/P Reference
	<i>2012).</i>	
	b. Verify that the records required by CAS 413.50(c)(7) are properly maintained and that investment earnings of the trust are allocated in accordance with CAS 413.50(c)(7).	
	c. Determine if the transfer of active or inactive employees among segments distorts the ratio of assets to the actuarial accrued liabilities.	
	d. If so, verify that assets equal to the employees' actuarial accrued liabilities (determined using the accrued benefit cost method) were transferred in accordance with CAS 413.50(c)(8) and (9). Consider requesting the assistance of the DCMA CIPR specialist through the ACO (CAM 5-1303.1c).	
	e. Verify that pension costs have been funded in accordance with CAS 412.50(d)(4) and FAR 31.205-6(j)(2)(iii); see IRS Form 5500, Schedule SB, line 18.	
	6. Determine if expressly unallowable costs, mutually agreed to be unallowable costs, cost which specifically become designed as unallowable by contractor office's, and directly associated costs are identified and excluded from the claimed cost (CAS 405) (FAR 31.201-6(a)).	
	7. Summarize the results including the conclusion, basis of proposed cost, and audit evaluation.	

H-01	Residual Allocation	W/P Reference
Version 3.2, dated June 2016		
	1. Verify that the expenses included in the residual pool are expenses incurred for managing the organization as a whole and have no readily measurable relationship to segments and cannot be allocated using one of the other CAS 403 methods (CAS 403.40(c)(1)).	
	2. If the contractor is not allocating residual pool expenses using the three factor formula, determine whether the contractor is required to use the three factor formula (CAS 403.40(c)(2)).	
	a. Identify the amount of residual expenses in the contractor's	

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H-01	Residual Allocation	W/P Reference
previous fiscal year.		
(1) Review the incurred cost claim, actual practices, disclosed practices, and/or applicable forward pricing proposals to determine if the contractor makes any “special allocations” of residual expense.		
(2) Verify that all unallowable costs are excluded from the proposal.		
b. Identify the total operating revenue for all segments for the previous fiscal year, distribute the operating revenue by the strata below, multiply the amount in each revenue strata times the corresponding percentage, and sum the product of each strata.		
	<u>Operating Revenue</u>	<u>Percentage</u>
First	\$100M	3.35
Next	\$200M	.95
Next	\$2.7B	.30
Over	\$3.0B	.20
c. Compare the previous residual expense value obtained in step 2a above to the calculated total value in step 2b. If the residual value exceeds the total value in step 2b, the three factor formula must be used. <i>If the contractor is not required to use the three factor formula and does not voluntarily elect to use it, skip to Step 6 below.</i>		
3. Examine the components of the base to ensure all applicable activity is included, except for costs subject to a special allocation under CAS 403.40(c)(3). Verify that all segments of the home office are included in the base.		
4. Determine that the allocation base correctly includes the appropriate amounts for the three factor formula.		
a. The percentage of the segment’s payroll dollars to the total payroll dollars for all segments.		
b. The percentage of the segment’s operating revenue to the total operating revenue of all segments. Verify that only net interdivisional purchases are included (amounts charged to other segments reduced by any amounts charged by other segments for purchases).		
c. The percentage of the average net book value of the sum of the segment’s tangible capital assets plus inventories to the total		

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H-01	Residual Allocation	W/P Reference
	average net book value of such assets of all segments.	
	(1) Verify that property held primarily for leasing to others is excluded.	
	(2) Verify that inventories are net of progress payment billings.	
	(3) Verify that inventories include work-in-process on fixed-price contracts.	
	(4) Determine that there are no double entries in the three factor formula (e.g., unbilled costs classified as revenue and inventory).	
	5. Recalculate the three factor formula based on the results of above audit steps (arithmetical average of the three percentages computed above).	
	6. If the contractor is not allocating residual pool expenses using the three factor formula, verify that the residual expenses are allocated over a base that represents the total activity of the segments (CAS 403.40(c)(1)).	
	7. Special Allocation of Residual Expenses (CAS 403.40(c)(3) and 50(d))	
	a. CAS 403.40(c)(3) requires agreements between the contractor and the contracting officer allowing the use of a “special allocation” of residual expenses.	
	b. Verify that the contractor’s allocation is consistent with the agreement, as disclosed in the Disclosure Statement.	
	c. Verify that the special allocation method is needed because a particular segment may receive significantly more or less benefit from residual expenses than would be reflected by the normal allocation methods. Be especially cognizant of changing conditions that may make previous determination inapplicable to the current year.	
	d. Verify that the special allocation base represents the cost of estimated or recorded efforts devoted to the segment (CAS 403.50(d)(3)).	
	e. Verify that the amount of such special allocation is excluded from the pool of residual expenses allocated via the three factor formula and such segment's data are excluded from the allocation base.	
	f. A contractor may not disclose the use of a special allocation; therefore, review the incurred cost proposal, actual practices, disclosed practices, and/or applicable forward pricing proposals to determine if the contractor makes any undisclosed “special	

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H-01	Residual Allocation	W/P Reference
	allocations” of residual expenses. If any special allocations are not based on an agreement, compute the impact using the approved method of allocating residual expenses, and if significant, prepare a CAS noncompliance report.	
8.	Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.	

A-1	Concluding Steps	W/P Reference
	Version 3.2, dated June 2016	
	1. Summarize and document the audit results, including any individual working paper packages used to audit specific areas of cost. Identify the requirements of the audit opinion and using professional judgment, select the appropriate opinion based on the evidence obtained.	
	2. If expressly unallowable costs were included in the certified proposal, prepare a schedule of questioned costs by penalty class and identify the business unit to which they are allocable in the home office audit report (CAM 6-609.3b).	
	3. Obtain supervisory review of the working papers and draft audit results section of the audit report before discussions with the contractor.	
	4. Prepare final draft audit report in accordance with Agency guidance and obtain management review.	
	5. Auditors should document and communicate with the contracting officer upon completion of the audit:	
	a. Brief the contracting officer on significant questions, unsupported, unresolved costs or other significant and/or complex findings/issues, or	
	b. Coordinate with the contracting officer to find out and determine if inclusion of detailed explanatory notes in our report would serve a useful purpose when there are no findings.	
	6. Conduct an exit conference and provide the audit results to the contractor. The contractor’s reaction should be obtained for inclusion in the final draft audit report.	

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7. Prepare any required audit leads and submit to supervisor for approval. Update permanent files and risk determination for next fiscal year based on findings/audit results. Determine if DMIS risk classification requires an update.	
8. If applicable, update the MAARs Control Log. Include a completed copy of the control log in this working paper package.	
9. Prepare and verify accuracy of dollars examined and questioned costs amounts for DMIS reporting.	
10. If significant instances of CAS noncompliances are found, coordinate and discuss with supervisory auditor and report under activity code 19200 in accordance with Agency guidance.	
11. If we identify a business system deficiency during the incurred cost audit, open a 11090 assignment to determine if the deficiency still exists today, and to fully develop and report material weaknesses/significant internal control deficiencies. <i>(Note: The issuance of the incurred cost audit is not dependent on the results of the 11090)</i>	