

Master Document – Audit Program

Activity Code 19403		Compliance Audit CAS 403
Version 6.17, dated November 2015		
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 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		
<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 403 establishes criteria for the allocation of home office expenses to the segments of the organization on the basis of a beneficial or causal relationship. CAS 403 does not provide guidance for the allocation of IR&D/B&P costs of a home office. CAS 403.40(b)(5) states that IR&D/B&P costs shall be allocated in accordance with CAS 420. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 403 criteria. 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 403. 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 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 standard. If the standard is not applicable 		

Master Document – Audit Program

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, 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 examinations, etc.). The decision to not test whether the contractor is complying with specific provisions of the standard should be documented.
4. Prior to commencing the audit, review guidance that may impact the audit and adjust the scope and procedures appropriately. Guidance to review includes CAM, open MRDs, FAQ training material, guidebooks, etc. available on the DCAA Intranet.

B-1	Preliminary Steps	W/P Reference
Version 6.17, dated November 2015		
1. Research and Planning		
	a. Read and become familiar with the criteria in CAS 403. Identify any changes in the CAS 403 standard since the last examination.	
	b. Evaluate Part VIII of the contractor’s disclosure statement to become familiar with the disclosed accounting practices. Determine if the contractor's accounting practices have changed since the last CAS 403 compliance audit. If changes have occurred, document the file and adjust the audit scope accordingly.	
	c. Evaluate recent forward pricing or incurred cost proposals to determine whether total costs subject to CAS 403 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.	
	d. Examine other 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.	

Master Document – Audit Program

<p>e. 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> <p>(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.</p> <p>(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>	
<p>f. 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> <p>(1) During the entrance conference:</p> <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. <p>(2) If the review of the perm file or the contractor identifies</p>	

Master Document – Audit Program

<p>relevant internal audits:</p> <ul style="list-style-type: none"> • Determine if access to these reports is necessary to 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. • 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 the 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) 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>g. If appropriate, coordinate with the FAO technical specialist, CAC, and/or regional specialist on matters of interpretation and policy.</p>	
<p>h. 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</p>	

Master Document – Audit Program

<p>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>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</p>	
<p>a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on:</p>	
<p>(1) Confirming that cost accounting policies and procedures are current.</p>	
<p>(2) Requesting the contractor's explanation of the internal control structure as relates to CAS 403.</p>	
<p>(3) Any changes since the last audit.</p>	
<p>(4) The contractor's monitoring process for classifying costs.</p>	
<p>(5) Any identified weaknesses which may have been reported and related follow-up actions. If applicable, include a follow up with contractor management on:</p> <ul style="list-style-type: none"> • corrective actions that address previous DCAA audit findings and recommendations (step 1f), • other studies or audits that impact the subject matter under audit (step 1g). 	
<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>3. Risk Assessment Steps</p>	

Master Document – Audit Program

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. Determine high-risk areas by performing the following limited testing. Using the most recent incurred cost or forward pricing proposal, or current operating results (financial statements):	
(1) Determine which pools are significant. (For immaterial pools/rates, discuss with technical specialist and/or supervisory auditor prior to performing additional effort.)	
(2) Compare the pools/bases to the disclosure statement to determine if any changes have been made to any accounting practices.	
(3) For each significant pool, determine that actual major functions and cost elements included in each pool and allocation base are consistent with Disclosure Statement.	
(4) Determine provisions of the standard that are material.	
d. During the entrance conference, or other appropriate meeting, make inquiries of contractor management regarding knowledge of any fraud or suspected fraud affecting the subject of this audit, managements awareness of allegations of fraud or suspected fraud affecting this audit, and management’s understanding about the risks of fraud relevant to this audit. Note: This discussion and any data submitted should be documented in the working papers.	
e. Based on the team's understanding of the criteria, subject matter, and the contractor and its environment, hold a planning meeting with the audit team (at a minimum, Supervisor and Auditor) to discuss and identify potential noncompliances, due to error or fraud, that could materially affect the subject matter. The discussion should include: <ul style="list-style-type: none"> • relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies), 	

Master Document – Audit Program

<ul style="list-style-type: none"> • 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 factor/indicators (see - Sources of Fraud Risk Factors below) that are present and could materially affect the subject matter. If Fraud risk factors are present, document specific audit procedures designed to address the increased risk of material 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>	
<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. Transaction testing should be increased when the contractor allocates a material amount of home office expenses through indirect pools (e.g., homogeneous and residual expense</p>	

Master Document – Audit Program

pools.)	
g. Update the information in the permanent files as needed. (MAAR 3)	

C-1	Evaluation of the Organization and Operations	W/P Reference
Version 6.17, dated November 2015		
1.	Identify all segments directed or managed by the home office by referring to organizational charts and financial statements.	
2.	Review permanent files and prior audit assignments (e.g., forward pricing, incurred cost and financial capability audits) to determine whether the contractor is involved in any off-balance sheet financing activities. If the contractor has off-balance sheet activity, determine the impact of the activity on the home office allocation bases (see CAM 9-703.4d).	
	<p>a. If the contractor is publicly held, off-balance sheet financing activities will be identified in the “Management’s Discussion and Analysis” (MDA) section of the contractor’s quarterly and annual SEC filings (see CAM 14-306a(1)). If a review of the SEC filings has not been performed in a prior audit for the period(s) covered by the CAS audit, review the SEC filing. Quarterly and annual SEC filings can be assessed via the Securities and Exchange Commission website at http://www.sec.gov.</p> <p>b. If the contractor is not publicly held, review the contractor’s last financial capability audit to determine if the contractor has provided written confirmation that its financial statements include disclosure of all off-balance sheet arrangements and related party transactions. If the contractor has not provided written confirmation, request the contractor to provide this documentation (See CAM 14-306a(2)).</p> <p>Note: A proforma letter requesting contractor confirmation of the financial statements is included in the APPS for Financial Capability Audits (17600), Other Audit Guidance section, entitled ConfirmLtr – Financial Statements.</p>	
3.	Coordinate/compare understanding of benefiting segments with the auditor cognizant of segments.	
4.	Understand functions, services, and responsibilities of various contractor operations by evaluating the organizational charts, descriptions of functional departments and operations, etc.	

Master Document – Audit Program

D-1	Classification of Home Office Expenses (MAAR 16)	W/P Reference
Version 6.17, dated November 2015		
1.	From the contractor’s most recent incurred cost submission, forward pricing rate proposal, or other supporting documentation, obtain a detailed breakdown of the contractor’s home office expenses.	
2.	Analyze the data obtained in step 1 above and determine if home office expenses are properly classified within the following three categories: (CAS 403.40(a)(1) and CAS 403.50(a)(1))	
	a. Directly allocated to segments.	
	b. Separately grouped in logical and homogeneous pools.	
	c. As residual for those managing the organization as a whole.	
3.	For any unusual classification of significant functions or cost centers, request the contractor to provide the rationale for the classification.	
4.	Evaluate indirect allocation of selected home office expenses to ensure no costs are allocated through a homogeneous pool or a residual pool if costs incurred for the same purpose have been allocated directly to a segment(s). (CAS 403.40(a)(2))	

E-1	Directly Allocated Cost (MAAR 18)s	W/P Reference
Version 6.17, dated November 2015		
1.	Evaluate the contractor’s direct allocation policies and practices to determine if they allow direct allocation to segments to the maximum extent practical. (CAS 403.40(a)(1))	
2.	Verify from the detailed breakdown of directly allocated costs that expenses that benefit only one segment are allocated directly to that segment. (CAS 403.40(a)(1))	

F-1	Homogenous Expense Pools (MAARs 16 & 18)	W/P Reference
Version 6.17, dated November 2015		
1.	Evaluate the service and management functions performed by each pool and determine if the pool is grouped in logical and homogeneous expense pools.	

Master Document – Audit Program

<p>2. For significant cost centers, determine and document which segments benefit from the cost (or cause the cost to be incurred). For example, if the contractor groups several accounts into a cost center described as “Payroll Processing”, determine if all payroll is processed through this center or just certain segments (such as the home office and the smaller segments).</p>	
<p>3. Obtain contractor’s rationale for excluding any segments from the base.</p>	
<p>4. Identify the contractor’s homogeneous expense pools by categories specified in CAS 403.40(b) for the purpose of evaluating allocation methods in accordance with the criteria provided therein:</p>	
<p>a. centralized service functions,</p>	
<p>b. staff management,</p>	
<p>c. line management,</p>	
<p>d. Central payments or accruals,</p>	
<p>e. IR&D/B&P, and</p>	
<p>f. staff management not identifiable with specific segments.</p>	
<p>5. Centralized Service Functions Verify that the selected allocation base complies with the hierarchy of preferable allocation techniques. (CAS 403.50(b)(1)).</p>	
<p>a. Activity Resource Consumption – Ensure that this allocation base (e.g., labor hours, machine hours, or square footage) is used unless unavailable or impractical.</p>	
<p>b. Units of Output – Determine that this measurement base (units of end product; for example, number of printed pages for a print shop) is used only if an activity resource consumption base is unavailable or impractical.</p>	
<p>c. Surrogate Measure of Consumption – Confirm that this allocation base is used only if (1) and (2) are impractical or unavailable. An example is head count of the segment receiving the benefit.</p>	
<p>6. Staff Management Functions</p>	
<p>a. Confirm that the costs of staff management functions of specific activities such as personnel management, engineering policies, etc., that are significant in total and in relation to total home office expenses are segregated from the residual cost pool. (CAS 403.40(b)(2) and (b)(6)).</p>	
<p>b. Verify that the allocation base includes all segments receiving more than a minimal benefit and represents the total specific activity being managed such as number of personnel managed.</p>	

Master Document – Audit Program

(CAS 403.40(b)(2)).	
7. Line Management Functions	
a. Evaluate the organizational charts and management hierarchy and responsibilities and determine which segments are managed or supervised. Line management costs are allocated only to segments which are being managed or supervised. (CAS 403.40(b)(3)).	
b. Evaluate the allocation base to determine if it represents the total activity of these segments (for example, total cost input). (CAS 403.40(b)(3)).	
8. Central Payments or Accruals	
a. Evaluate the details of each pool for indirect allocation to determine that the pooled costs do not include central payments or accruals (e.g., group insurance, state taxes, etc.) that can be identified specifically with individual segments. (CAS 403.40(b)(4))	
b. For those payments/accruals that cannot be identified specifically with individual segments, confirm that the allocation base is representative of the factors on which the total payment/accrual is based. (CAS 403.40(b)(4)).	

G-1	Residual Expenses (MAARs 16 and 18)	W/P Reference
Version 6.17, dated November 2015		
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.	Determine if 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 previous fiscal year.	
	(1) Verify that all unallowable costs are excluded.	
	(2) Verify that all residual expenses to be allocated using a “special allocation” (see d. below) are included.	
b.	Identify the total operating revenue for all segments for the previous fiscal year and apply the following formula:	
	<i>Operating Revenue</i>	<i>Percentage</i>

Master Document – Audit Program

<i>First</i>	\$100M	3.35	
<i>Next</i>	\$200M	.95	
<i>Next</i>	\$2.7B	.30	
<i>Over</i>	\$3.0B	.20	
c. Compare the previous residual expense value obtained in step 1 above to the calculated value in step 2. If the residual value exceeds the step 2 calculated value, 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 3 or 4 below.</i>			
d. Verify the calculation of the three-factor formula. 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))			
e. Determine that the allocation base correctly includes the appropriate amounts for the three-factor formula.			
(1) The percentage of the segment’s payroll dollars to the total payroll dollars for all segments.			
(2) 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.)			
(3) The percentage of the average net book value of the sum of the segment’s tangible capital assets plus inventories to the total average net book value of such assets of all segments.			
(a) Verify that property held primarily for leasing to others is excluded.			
(b) Verify that inventories are net of progress payment billings.			
(c) 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).			
f. Verify the mathematical accuracy of the three factor formula (arithmetical average of the three percentages computed above).			
g. Verify that any residual expenses allocated via a special allocation method (step d. below) are removed from the residual pool and that the applicable segment’s data are excluded from the base.			

Master Document – Audit Program

3. Verify that the residual expenses are allocated over a base that represents the total activity of the segments (CAS 403.40(c)(1)). Do not perform this step if the three-factor formula is used (step 2 above).	
4. Special Allocation of Residual Expenses (CAS 403.40(c)(3) and 40(d))	
a. Obtain the agreements between the contractor and the contracting officer allowing the use of a “special allocation” of residual expenses, if any.	
b. Verify that the contractor’s allocation is consistent with the agreement.	
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 a special allocation is excluded from the pool of residual expenses and such segment's data are excluded from the allocation base.	

A-1	Concluding Steps	W/P Reference
Version 6.17, dated November 2015		
1.	Summarize and document the results of audit.	
2.	<p>Discuss the audit results with the supervisor and, if applicable the Technical Specialist. The auditor should only report those noncompliances which are considered material. 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, 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.</p> <p>Note: If a noncompliance is considered immaterial, but could become material if circumstances change, notify the CFAO through a memorandum. The memorandum will include a Statement of Condition and Recommendation (SOCAR) and provide the CFAO with sufficient</p>	

Master Document – Audit Program

<p>information to understand the condition and the severity of the CAS noncompliance. The only exception to issuing a memorandum is if the audit report includes a material noncompliance. When a material noncompliance is reported, the immaterial noncompliance will be reported in a separate exhibit to the report titled "Noncompliance that Warrants Attention of the Cognizant Federal Agency Official." Reference to the exhibit for the immaterial noncompliance will be in the Executive Summary, but will not be included in the Basis of Opinion section, as it is not a material noncompliance.</p>	
<p>3. Prepare draft audit report (and memorandum, if applicable). If the audit scope was limited to a certain area(s) of the contractor’s accounting practices, modify the subject matter stated in the Report On (from w/p A-01) and Opinion (from w/p A) section of the report, as necessary, so that they clearly identify the limited areas audited.</p>	
<p>4. If a material weakness/significant internal control deficiency is detected during the course of this audit, ensure that the findings have been fully developed and that a material weakness truly exists. If so, open a Business System Deficiency (Activity Code 11090) assignment to report the deficiency and submit it to the contractor for comment.</p>	
<p>5. Hold an exit conference with the contractor and provide a draft report (and memorandum, if applicable) to the contractor for comments in accordance with CAM 4-304. Obtain supervisory review, and management review if required, of the working papers and draft audit results section of the audit report (and memorandum, if applicable) before discussion with the contractor.</p>	
<p>6. Finalize audit report (and memorandum, if applicable) incorporating the contractor’s reaction and response, if applicable.</p>	
<p>7. Complete the administrative working papers.</p>	
<p>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></p>	
<p>9. Submit the working paper package and draft report (and memorandum, if applicable) to the supervisor/manager for final review and processing.</p>	