

Master Document –Audit Program

Activity Code 19420		Compliance Audit CAS 420
Version 5.15, 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 420 establishes criteria for the accumulation of IR&D/B&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. 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 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. 		
Other Planning Considerations		
<ol style="list-style-type: none"> 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. 		

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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 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 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 5.15, dated November 2015		
1. Research and Planning		
a.	Read and become familiar with the criteria in CAS 420, Chapter 33 of the Selected Areas of Cost Guidebook, CAM 8-420, and any recent Headquarters guidance not incorporated in CAM.	
b.	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.	
c.	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.	
d.	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.	

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<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> <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>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> <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	

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<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 accordingly. If information regarding the contractor’s financial condition is not available from the contracting officer, the auditor</p>	

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<p>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>	
2. Entrance Conference	
<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. 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>	
3. Risk Assessment Steps	
<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</p>	

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<p>should be able to obtain and document a major portion of this understanding during a walk-through of the contractor's assertion.</p>	
<p>c. 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.</p>	
<p>d. 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.</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 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>	

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<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>e. 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>f. Update the information in the permanent files as needed (MAAR 3)</p>	

C-1	Accumulation of IR&D / B&P Costs by Project (MAAR 16)	W/P Reference
Version 5.15, dated November 2015		
	<p>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.</p>	
	<p>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)).</p>	
	<p>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.</p>	
	<p>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</p>	

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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)).	

D-1	Accumulation of IR&D / B&P Costs by Pool	W/P Reference
Version 5.15, dated November 2015		
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)	
	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))	

E-1	Allocation to Cost Objectives (MAAR 18)	W/P Reference
Version 5.15, dated November 2015		
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)).	

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<p>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)).</p>	
<p>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)).</p>	

F-1	Inter-Segment IR&D / B&P Effort	W/P Reference
Version 5.15, dated November 2015		
	<p>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.</p>	
	<p>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.</p>	
	<p>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.</p>	

G-1	Deferral of IR&D / B&P Costs	W/P Reference
Version 5.15, dated November 2015		
	<p>1. Determine that all B&P costs incurred during a cost accounting period are assigned to that period only. (CAS 420.40(f)(1)).</p>	
	<p>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)).</p>	

H-1	Home Office IR&D / B&P Costs	W/P Reference
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	<p>1. Coordination with segment auditors regarding accumulation of IR&D/B&P costs by the home office:</p>	

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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 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)).	

A-1	Concluding Steps	W/P Reference
Version 5.15, dated November 2015		
1.	Summarize and document the results of audit.	
2.	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. Note: If a noncompliance is considered immaterial, but could become material if circumstances change, notify the CFAO through a	

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<p>memorandum. The memorandum will include a Statement of Condition and Recommendation (SOCAR) and provide the CFAO with sufficient 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(s). 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 auditor’s 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>	