

Master Document – Audit Program

Activity Code 19403		Compliance Audit CAS 403
Version 5.0, dated April 2004		
B-1	Planning Considerations	
Purpose and Scope		
<ol style="list-style-type: none"> 1. The purpose of CAS compliance auditing is to determine if the contractor's policies, procedures, and practices used to estimate, accumulate, and report costs on Government contracts and subcontracts comply with the requirements of CAS. CAS 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. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 403 criteria. 		
<ol style="list-style-type: none"> 2. The scope of this audit should generally be limited to CCFY. Some limited testing of prior years transactions is acceptable to assure that no system changes were made. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms. 		
<ol style="list-style-type: none"> 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 to the contractor or noncompliance with the standard overall has no significant impact on Government contract costs, there is no need to test whether the contractor is complying with the standard. The decision to not test for CAS compliance should be documented (see CAM 8-305 and DoD CAS Working Group Paper 76-7). 		
<ol style="list-style-type: none"> 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 and frequency of CAS compliance tests. 		

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3. Once it is determined that the standard is applicable and has a potential material impact, 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.

B-1	Preliminary Steps	WP Reference
Version 5.0, dated April 2004		
1.	Research and Planning	
a.	Read and become familiar with the criteria in CAS 403, CAM 8-403, and any recent Headquarters guidance not incorporated in CAM.	
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 remained unchanged since the last CAS compliance audit. If changes have occurred, adjust 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). If not material, discuss with the supervisory auditor before continuing audit.	
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.	
e.	Discuss the planned compliance audit with the CFAO and, if appropriate, other customers to identify, understand, and document any concerns they may have or areas that should be evaluated.	
2.	Entrance Conference	
a.	Arrange and conduct an entrance conference covering the areas	

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highlighted in CAM 4-302 with particular emphasis on:	
(1) Confirming that cost accounting policies and procedures are current.	
(2) Requesting the contractor's explanation of the internal control structure as relates to CAS 403.	
(3) Any changes since the last audit.	
(4) The contractor's monitoring process for classifying costs.	
(5) Any identified weaknesses which may have been reported and related follow-up actions.	
b. If reliance is to be placed on the work of others, the file should contain the required documentation (see CAM 4-1000).	
3. Risk Assessment Steps	
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. If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained during the audit is highly dependent on computerized information systems, document on working paper B-2, the audit work performed that supports reliance on the computer-based evidential matter. Specifically, document or reference one or more of the following in working paper B-2:	
(1.) The audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits,	
(2.) The procedures/tests that will be performed in this audit to evaluate the incurred costs that will also support reliance on the evidential matter, and/or	
(3.) The tests that will be performed in this audit that will be specifically designed to test the reliability of the computer based data.	
When sufficient work is not performed to determine reliability (i.e., reduce audit risk to an acceptable level), qualify the audit report in accordance with CAM 10-210.4a and 10-504.4a.	
c. Document the impact of the current assessment of the contractor's internal control structure relative to this standard (control environment, accounting system, and relevant policies,	

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procedures, and practices) on the audit scope.	
d. 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.	
e. In planning and performing the examination, consider the fraud risk indicators in CAM Figure 4-7-3 for applicability to this audit. Document in working paper B any identified fraud risk indicators and your response/actions to those identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.	
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 pools.)	
g. Update the information in the permanent files as needed. (MAAR 3)	

C-1	Evaluation of the Organization and Operations	WP Reference
Version 5.0, dated April 2004		
1.	Identify all segments directed or managed by the home office by referring to organizational charts and financial statements.	
2.	Coordinate/compare understanding of benefiting segments with the auditor cognizant of segments.	

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3.	Understand functions, services, and responsibilities of various contractor operations by evaluating the organizational charts, descriptions of functional departments and operations, etc.	
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D-1	Classification of Home Office Expenses (MAAR 16)	WP Reference
Version 5.0, dated April 2004		
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 a. 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 cost incurred for the same purpose have been allocated directly to a segment(s). (CAS 403.40(a)(2))	

E-1	Directly Allocated Costs	WP Reference
Version 5.0, dated April 2004		
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)	WP Reference
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1. Evaluate the service and management functions performed by each pool and determine if the pool is grouped in logical and homogeneous expense pools.	
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).	
3. Obtain contractor’s rationale for excluding any segments from the base.	
4. Identify the contractor’s homogeneous expense pools by categories specified in CAS 403.40(b) for the purpose of evaluating allocation method in accordance with the criteria provided therein:	
a. centralized service functions,	
b. staff management,	
c. line management,	
d. Central payments or accruals,	
e. IR&D/B&P, and	
f. staff management not identifiable with specific segments.	
5. Centralized Service Functions Verify that the selected allocation base complies with the hierarchy of preferable allocation techniques. (CAS 403.50(b)(1)).	
a. Activity Resource Consumption – Ensure that this allocation base (e.g., labor hours, machine hours, or square footage) is used unless unavailable or impractical.	
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.	
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	
6. Staff Management Functions	
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	

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403.40(b)(2) and (b)(6)).	
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. (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)).	
9. Determine if IR&D/B&P costs of the home office are allocated in accordance with CAS 420. (MAAR 17).	

G-1	Residual Expenses (MAAR 16 and 18)	WP Reference
Version 5.0, dated April 2004		
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.	Obtain the amount of residual expenses in the contractor's previous fiscal year.	
	(1) Verify that all unallowable costs are excluded.	

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(2) Verify that all residual expenses to be allocated using a “special allocation” (see d. below) are included.		
b. Obtain the total operating revenue for all segments for the previous fiscal year and apply the following formula:		
	<i>Operating Revenue</i>	<i>Percentage</i>
<i>First</i>	<i>\$100M</i>	<i>3.35</i>
<i>Next</i>	<i>\$200M</i>	<i>.95</i>
<i>Next</i>	<i>\$2.7B</i>	<i>.30</i>
<i>Over</i>	<i>\$3.0B</i>	<i>.20</i>
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.		
(a) Verify that only net interdivisional purchases are included (amounts charged to other segments reduced by any amounts charged by other segments for purchases.)		
(b) Verify that unbilled costs on CPFF and T&M contracts are included		
(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 of net of progress payment billings.		
(c) Verify that inventories include work-in-process on fixed price contracts		

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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 is excluded from the base.	
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 is excluded from the allocation base.	

A-1	Concluding Steps	WP Reference
	Version 5.0, dated April 2004	
	1. Summarize the results of audit.	
	2. Discuss results with the supervisor or the Technical Specialist/supervisory auditor. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7). Coordinate significant or unusual issues with the CFAO, FAO Manager, and if applicable, with the CAC, CHOA, or GAC network (see CAM 8-302.4, 8-302.6). Coordination should be both before and after discussion of results with the contractor. The ACO should be apprised of noncompliance matters at the earliest possible date. If a	

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<p>noncompliance is considered immaterial, recommend to the CFAO that the contractor be notified to reserve the Government's right should the cost impact become material (see FAR 30.602)</p>	
<p>3. Prepare draft audit report in accordance with CAM 10-807(activity code 194XX) when no instances of noncompliances are found, or CAM 10-808 (activity code 19200) when instances of noncompliances are found.</p>	
<p>4. Conduct an exit conference with the contractor in accordance with CAM 4-304.</p>	
<p>5. Finalize audit report incorporating the contractor’s response and rejoinder, if applicable.</p>	
<p>6. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented in (e.g., by initials and date on the CD or working paper folder, etc) and should include:</p>	
<p>a. The title, author, and keywords fields of the file properties in the audit report must be completed (for the audit report only) prior to final filing.</p>	
<p>b. Review the APPS exe file for size. APPS-generated executable files that are over 10 megabytes in size should be reviewed to ensure that the format and content justify the size. Supervisors are responsible for reviewing or designating someone to review these files for content and format.</p>	
<p>c. Review the APPS exe file for temporary files. These files can be recognized by the “~\$” or “~WRL” at the beginning of the file name. Once the APPS exe file is complete and there is NO ACTIVITY to be completed on any of the files contained within the exe file, any temporary files should be deleted so there are no unintentional versions of working papers and/or reports. NOTE: This should be done prior to invoking the Export/Archive Option in APPS.</p>	
<p>d. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should be password protected. The electronic file should then be renamed according to the convention “01 DCAA Report [RORG-ASSIGNMENT NO.] – Final.doc” and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes. For Memorandums the word “Report” would be replaced by “MFF” or “MFR” in the naming convention as appropriate.</p>	

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<p>e. When the audit report is transmitted electronically to the requestor, the transmission email should be saved as a txt file (this will ensure the attachments are not saved again). Saving delivery or read receipts is optional. If saved, the naming convention should distinguish them from transmittal emails.</p>	
<p>f. Once the report is signed, the signature page of the audit report must be scanned in accordance with Agency standard scanning instructions. For audit packages, the scanned signature page file should be named the same as the audit report (see above) with “-sig” added (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.pdf). There is no requirement to make the file a part of the APPS generated executable file and it must be included separately in the iRIMS folder. There is no need to scan the signature page of a Memorandum unless it is distributed outside of DCAA.</p>	
<p>g. Ensure an electronic copy of the final draft audit report containing the supervisory auditor’s initials and date, cross-referenced to the working papers, is included in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative</p>	
<p>h. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.</p>	
<p>i. Two complete sets of electronic working papers should be filed. One set (official) will be filed in iRIMS. A second set (backup) will be stored on removable media in the hard copy working paper folder. The new APPS naming convention (ex: 01701_2003A10100001_Archive_093003.exe) will be used for both. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.</p>	
<p>j. Verify using a separate machine, that electronic files stored on removable media are not corrupted and can be unarchived. Indicate the test was successful by placing tester initials and date prominently on the CD label.</p>	
<p>k. Securely enclose the “backup” set of electronic files (CD) and any “official” set of hard copy in the hard copy folder.</p>	
<p>l. File the “official” set of electronic files in iRIMS (see iRIMS User Guide).</p>	
<p>m. <u>Do Not File Sensitive Audits in iRIMS</u>: Sensitive audits include but are not limited to classified work, suspected irregular conduct,</p>	

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<p>hotline or DCAA Form 2000 related files. These audits should not be filed in iRIMS at this time. See CAM 4-407f for filing instructions.</p>	
<p>7. Update the permanent files, i.e., ICAPS or ICQ, and Mandatory Annual Audit Requirements schedules. <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>	