

**Master Document – Audit Program**

<b>Activity Code 19416</b>	<b>Incurred Insurance Cost and CAS 416 and FAR Compliance</b>
<b>Version 2.0, dated April 2004</b>	
<b>B-1</b>	<b>Planning Considerations</b>
<p><b>Note to DCMA/DCAA:</b> Those review/audit steps not required should be marked "not applicable" (N/A) by the team leader. Portions of the review/audit steps which are covered in other assignments (e.g. incurred cost, Disclosure Statement, and internal control audits) should be referenced at the appropriate place in this program. Also, the team may adjust the steps to meet its specific needs.</p>	
<p><b>Note to Auditor:</b> The joint DCMA/DCAA review/audit steps included in this program are limited to the evaluation of group insurance costs (primarily group health and group life insurance) and do not cover liability insurance costs (e.g., workers' compensation, general liability, product liability, etc.) or casualty insurance costs (e.g., fire insurance, business interruption insurance, and insurance on the lives of officers and owners). The audit of incurred insurance costs and compliance with CAS 416 must include the evaluation of costs of all types of insurance which are significant at the contractor. Therefore, audit steps covering liability and casualty insurance costs are included with the available sections on the Planning/Standards tab and should be selected for incorporation into this review/audit based on the risk assessment. Section A, Preliminary Review/Audit Steps including the risk assessment procedures should be modified to cover all types of insurance and not just group insurance. The steps for liability and casualty insurance costs have not yet been adopted as joint review steps; therefore, the auditor should coordinate with the DCMA insurance/pension specialist team member regarding responsibility for performing the steps related to those costs. DCAA is responsible for performing contract audit responsibilities related to CAS; therefore, all steps related to CAS compliance should be performed by the DCAA team member with the technical assistance of the DCMA insurance/pension specialist when appropriate.</p>	
<p>When a joint review is not performed due to low audit risk, this audit program should be modified as appropriate based on the risk assessment.</p>	
<b>Purpose and Scope</b>	
<p>The scope of the program must be tailored to the requirements of each review/audit, based on the types of group insurance coverage, the methods of coverage (i.e., purchased or self-insurance), review/audit risk assessment, prior review/audit coverage, etc. Accordingly, the ultimate review/audit program should reflect a mutual understanding between the team captain, the auditor, and the supervisor as to the scope required to meet auditing standards as well as DCMA and DCAA objectives for the group insurance</p>	

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review/audit assignment.
The purpose of the review/audit is to determine whether a contractor's group insurance costs claimed on Government contracts meet the measurement, assignment and allocability requirements of Cost Accounting Standard 416, "Accounting for Insurance Costs," and are allocable, reasonable, and allowable per the applicable provisions of FAR Subpart 31.2. DCAA and DCMA have a joint responsibility for the review/audit of group insurance cost; thus, the review/audit scope should be established accordingly. Guidance contained in CAM 5-1303 should be read by the auditor prior to the start of the audit.
Group insurance costs represent a significant Government contract cost item, and include different types of group insurance subject to review/audit. Examples of types of group insurance costs are group health, group life, and group disability coverage. Each type of group insurance presents unique problems and must be considered on an individual basis. The review/audit program steps are intended to cover all aspects of group insurance focusing on the allowability and allocability of such costs and compliance with appropriate Cost Accounting Standards and FAR Subpart 31.2. Full implementation of the review/audit steps requires (1) ability to measure group insurance costs, (2) knowledge of the basic concepts of group insurance accounting, (3) familiarity with group insurance terminology, (4) understanding of CAS 416 and FAR Parts 28 and 31, (5) knowledge of postretirement benefit (PRB) accounting principles in FASB Statement No. 106, (6) understanding of group insurance plans and provisions, (7) understanding of the methods used for filing and paying claims, and (8) understanding of IRS Form 5500 and related schedules.
Although this review/audit program includes references to cost containment and risk management measures, and performance of the detailed review/audit steps could result in recommendations involving the reasonableness of group insurance costs and the economy and efficiency of contractor group insurance operations, other types of review/audits may be conducted which also result in reasonableness and economy and efficiency determinations. For example, as part of a compensation evaluation, a determination of the reasonableness of employees' group insurance coverage would be one of the considerations in determining the overall reasonableness of the compensation plan. It is important that the various types of review/audits be integrated in the program plan to assure appropriate, comprehensive coverage of contractor group insurance costs.
This joint review/audit program is not all inclusive. Supplement the program as necessary to cover additional group insurance areas unique to individual contractors.
<b>Pre-planning Team Meeting</b>
The DCMA/DCAA team members will coordinate on the nature and objectives of the audit/review, noting any specific requirements and select a team leader. DCAA will be responsible for performing contract audit responsibilities related to CAS (with the technical assistance of the DCMA insurance/pension specialist when required). The team will also identify and assign a team member responsible for performing review/audit

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steps that can be performed by either agency. Normally DCMA serves as team leader; however, DCAA can serve as team leader if both agencies agree (See DFARS 242.7303(b)).
The team leader will prepare a consolidated request to the contractor listing the data and documents necessary to accomplish the joint review/audit objectives. The team leader will issue the final report to the ACO.
<b>Reporting Joint Review/Audit Results</b>
Each agency will perform their portion of the joint review/audit program; however, only one joint report will be issued to the ACO. The team leader will issue the joint report incorporating the results of the other team member’s report and attach a copy of the other team member’s report to the joint report. The team leader will ensure that team members or associated Agency receive copies of the joint report.
<b>References</b>
1. FAR Part 28, Bonds and Insurance and FAR Part 31, Contract Cost Principles and Procedures
2. FAR 31.205-19, Insurance and Indemnification
3. FAR 31.205-6(o), Postretirement Benefits Other Than Pensions
4. Statement of Financial Accounting Standards No. 106
5. CAS 416, Accounting for Insurance Costs
6. CAM 5-1303, Audit of Contractor Insurance Cost and Pension Costs
7. DFARS 242.73, Contractor Insurance/Pension Review (CIPR)
8. CAM 7-500, Section 5 - Insurance Costs
9. CAM 8-416, Cost Accounting Standard 416 – Accounting for Insurance Cost
10. DCMA One Book, Chapter 10.2
11. Actuarial Standards of Practice (ASOP) of the Actuarial Standards Board, ie, ASOP #5, #9, #13, #20, #25

<b>B-1</b>	<b>Preliminary Steps</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
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1. Evaluate the following guidance and regulations:		
a. DCMA One Book, Chapter 10.2.	DCMA	
b. CAM 8-416 and 7-500, and any recent Headquarters guidance not incorporated into CAM.	DCAA	
c. FAR 31.205-6(o), FAR 31.205-19, FAR 28.3, DFARS 242.73 and CAS 416.	DCMA and DCAA	
2. Evaluate Part VII of the contractor’s CAS Disclosure Statement to determine disclosed practices for handling insurance. Determine if the contractor’s practices have changed since the last joint review or CAS 416 compliance audit. If changes have occurred, document the file and adjust scope of audit accordingly.	DCMA and DCAA	
3. Check the permanent files (including audit leads from other relevant audits), previous joint review and CAS 416 reports and related working papers on contractor’s group insurance cost to determine what data are available, what steps were done in the past, and the results of those steps. This will identify areas of high risk and/or areas where limited or no testing is necessary.	DCMA and DCAA	
4. Hold a planning meeting prior to the entrance conference to develop the entrance conference agenda and identify data to obtain during the entrance conference including the following (if not available in the permanent files):	DCMA and DCAA	
a. Provisions of the group insurance plans to include insurance policies, insurance agreements, summary plan descriptions, etc.		
b. Contractor’s internal and independent auditor’s report on group insurance plan activities.		
c. Management and group insurance carrier reports (to identify any potential problem areas. These reports evaluate existing programs, recommend changes, determine current costs, and disclose cost composition.)		
d. IRS Form 5471, Information Return with Respect to a Foreign Corporation, and Schedules M, N, and O (to assist in determining if the contractor’s insurance carrier(s) is a captive insurer or fronting insurance company.)		
e. Copies of contractor’s IRS Form 5500 which details		

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insurance reserves when reserves are held by the carrier.		
f. A listing from the contractor detailing the group insurance coverage. (See Insurance Summary Schedule in Other Audit Guidance)		
g. Documentation related to competitive quotations for insurance coverage if the contractor obtains these periodically.		
5. Hold an entrance conference and establish a contractor contact for the group insurance review. (See CAM 4-302.) Obtain data needed to conduct the review/audit. (See 4 above)	DCMA and DCAA	
6. 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 (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.	DCAA	
7. In planning the audit, consider the impact of SAS 70, <i>Reports on the Processing of Transactions by Service Organizations</i> , as amended by SAS 88, <i>Service Organizations and Reporting on Consistency</i> , on audit scope by performing the following steps:	DCAA	
a. Determine if the contractor (user organization) uses any service organizations.	DCAA	
b. If service organizations are used, determine if the transactions processed by the service organization are material.	DCAA	
c. If transactions are material, determine if the service organization is part of the user organization's information system.	DCAA	
d. If so, determine the degree of interaction between the service organization and the user organization. If high (as in the case of payroll processing, where the service organization receives time and attendance information from the user organization, prepares the payroll, writes the checks, etc. and then the user organization performs tests of the processed payroll for accuracy), there is no need to obtain an understanding of the service organization's controls.	DCAA	

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If low (as when a trustee manages pension assets):		
(1.) Obtain and analyze the service agreement (contract)	DCAA	
(2.) Obtain and analyze the service auditor’s report (if any) referring to the guidance in CAM 4-1000, “Relying on the Work of Others.”	DCAA	
(3.) If necessary, obtain and analyze other information available at the user organization including user manuals, system descriptions, technical manuals, and other policies and procedures.	DCAA	
(4.) If necessary, obtain and analyze any reports prepared by the user or service organizations’ internal auditors relating to internal controls over transactions and processes.	DCAA	
(5.) If necessary and with appropriate permission, visit the service organization and perform procedures or request an assist audit.	DCAA	
e. Summarize effects of audit of service organizations on scope of current audit.	DCAA	
8. Perform and document risk assessment:		
a. Gain an understanding of the contractor’s internal control structure by evaluating the ICQ or relevant ICAPS (whichever are applicable). In particular, determine if the contractor has a formal review program to reduce risk. If a contractor review program exists, obtain details and incorporate evaluation steps in appropriate sections of the audit program. If a contractor review program doesn’t exist, include recommendation for such a program in the review/audit report. Identify any known outstanding system deficiencies. Assess control risk.	DCAA	
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:	DCAA	

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(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 or 10-804.4a, whichever is applicable in this circumstance.		
c. Determine high risk areas by performing the following:		
(1) Using the Insurance Summary Schedule located in Other Audit Guidance and the information obtained from the contractor in preliminary step 4 f on working paper B-1 above, identify the contractor’s group insurance with specific types of coverage (i.e., health, life, etc.). Determine which is self group insurance and which is purchased group insurance. Use the form to identify significant group insurance costs to be evaluated. A copy of the completed schedule should be maintained in the FAO permanent file.	DCAA	
(2) Determine which provisions of CAS 416 and the relevant FAR are material.	DCMA and DCAA	
d. From the information gathered in the preceding steps and using the materiality criteria in 48 CFR 9903.305, assess the risk and coordinate the scope of review/audit with the team leader. Assign the review/audit steps identified based on risk assessments.	DCMA and DCAA	

<b>C-1</b>	<b>General Steps – Group Insurance</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
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1. Determine if any change in benefits significantly increased the cost to the Government, and if so, such increase was approved by the contracting officer. (FAR 28.307-1)	DCMA	
2. Compare the amount of cost to the cost in prior years, taking into consideration population changes and standard cost trend rates. Obtain the contractor’s explanation for any significant changes.	DCMA	
3. Using the information obtained in working paper B-1, step 4.d, determine if the contractor’s insurance carrier is a captive insurer or fronting insurance company.	DCMA or DCAA	
a. Insurance provided by a captive insurer should generally be evaluated as self-insurance. However, if the captive insurer also sells insurance to the general public and the charge to the contractor is based on competitive market forces, the insurance should be evaluated as purchased insurance. (FAR 31.205-19 (c))	DCMA or DCAA	
b. If the contractor purchases insurance from a fronting insurance company, the allowable premium cannot exceed the amount which the contractor would have been allowed had it insured directly with the captive insurer plus reasonable fronting company charges. (FAR 31.205-19 (d))	DCMA or DCAA	

<b>D-1</b>	<b>Purchased Group Insurance</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>			
1.	Reconcile the purchased group insurance costs selected for evaluation to the insurance policy or policies.	DCAA	
2.	Verify that the premium cost applicable to a given policy term are assigned pro rata among the cost accounting periods covered by the policy term. However, if the premium is directly allocated to a single final cost objective, the premium need not be pro rated. (CAS 416.50(a)(1)(i)&(ii))	DCAA	
3.	Verify that the contractor’s insurance plan provides for the Government to share in dividends, refunds and credits paid or otherwise allowed to the contractor. (FAR 28.307-1(b))	DCMA	

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4. Verify that refunds, dividends or additional assessments are an adjustment to the cost assigned to the earliest period in which the refund or dividend is actually or constructively received (i.e., they should not be prorated). (CAS 416.50(a)(1)(i))	DCAA	
a. A confirmation to the insurer may be used to determine if a refund, dividend or other credit has been paid to the contractor.	DCAA	
b. The auditor may need to look for credits in accounts other than insurance expense; such as other income, other expense, etc.	DCAA	
c. If the group life insurance plan uses whole life insurance, determine how the cash value and related dividends are handled (if material). If the contractor retains control of these items, the insurance expense should be credited for a like amount.	DCAA	
5. Verify that the group insurance cost is properly reduced for employee contributions.	DCMA or DCAA	
6. Ensure that the Government is not charged for payments related to premium stabilization reserves or contingencies. (CAS 416.50(a)(1)(iii) and FAR 31.205-7)	DCAA with DCMA tech. asst.	

<b>E-1</b>	<b>Self-Insurance - Group Insurance</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>			
1.	Examine the self- group insurance plan to determine what the program covers.	DCMA	
2.	If insurance could be purchased, verify the self insurance charge does not exceed the cost of purchased insurance, adjusted for the contractor experience. (CAS 416.50(a)(2)(i))	DCAA with DCMA tech. asst.	
3.	If insurance could not be purchased, verify the cost is based upon the contractor’s experience, relevant industry experience, and anticipated conditions in accordance with generally accepted actuarial principles. (CAS 416.50(a)(2)(i))	DCAA with DCMA tech. asst.	
4.	Verify that the group insurance cost is properly reduced for employee contributions.	DCMA or DCAA	

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5. Determine who administers the self- group insurance program; the contractor or a third party.	DCMA	
a. If the contractor administers the program, examine the procedures for paying claims. Identify and evaluate the contractor’s internal controls for administering the group insurance program. Identify and evaluate the screening process for determining an allowable claim. If the screening process is not adequate to determine allowable claims in accordance with the group insurance policy provisions, question the unauthorized claims and the related costs.	DCAA	
b. If a third party pays the claims, there is a fee associated with the service. Determine whether the fee is in accordance with the service contract and is reasonable.	DCMA	
6. Determine whether the contractor is properly accruing the cost of claims incurred in the current year that are paid in the next year (referred to as an IBNR reserve).	DCMA	
7. Where the liability is composed of reasonably certain payments made more than one year after the loss is incurred, e.g. disability benefits, ensure that the loss used to calculate the self-group insurance cost does not exceed the present value of such payment in accordance with CAS 416.50(a)(3)(ii).	DCAA	
8. For self-insurance of retirees that is not funded, verify that the projected average loss is represented by the pay-as-you-go (PAYGO) amount (i.e., actual losses). (CAS 416.50(a)(2)(iii))	DCAA	

<b>F-1</b>	<b>Funding Group Insurance</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>			
1.	Ensure that payments to a reserve or fund, which are treated as deposits in accordance with generally accepted accounting principles (i.e., reportable as such in published financial statements), are treated as deposits for determining group insurance costs.(CAS 416.50(a)(1)(iii))	DCAA with DCMA tech. asst.	
2.	Ensure that payments to a reserve or fund which are not	DCAA with	

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treated as deposits in accordance with generally accepted accounting principles, are treated as deposits for determining group insurance costs unless all of the following conditions are met: (CAS 416.50(a)(1)(iv))	DCMA tech. asst.	
a. The objectives of the reserve or fund are clearly stated in writing. (CAS 416.50(a)(1)(iv)(A))	DCAA with DCMA tech. asst.	
b. The cost is actuarially determined and consistent with the objectives of the fund. (CAS 416.50(a)(1)(iv)(B))	DCAA with DCMA tech. asst.	
c. Payments to the fund are made in a systematic and consistent manner. (CAS 416.50(a)(1)(iv)(C))	DCAA with DCMA tech. asst.	
d. If benefits are provided from a source other than the reserve or fund, contributions to the reserve or fund are reduced accordingly. (CAS 416.50(a)(1)(iv)(D))	DCAA with DCMA tech. asst.	

<b>G-1</b>	<b>Allocation of Insurance Cost – Group Insurance</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>			
1.	Determine whether group insurance costs are allocated to cost objectives based on causal or beneficial relationship: (CAS 416.40(b))	DCAA	
a.	For self-insurance, verify that where actual losses are recognized as an estimate of the projected average loss, losses which are incurred by a given segment are identified to that segment. (CAS 416.50(b)(1))	DCAA	
b.	Verify that group insurance costs are allocated on the basis of the factors used to determine the premium, assessment, refund, dividend or self-insurance charge (CAS 416.50(b)(2)), or	DCAA	
c.	If group insurance costs of a segment are combined with costs of other home office indirect cost pools, determine that the resulting group insurance cost allocated to segments is substantially the same as it would have been had the cost been accumulated by segment. (CAS 416.50 (b)(2))	DCAA	

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<b>H-1</b>	<b>Postretirement Benefit (PRB) Costs</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>			
<i>The following steps apply if the contractor uses accrual accounting to measure and assign PRB costs.</i>			
1.	Determine whether the actuarial assumptions used to compute the terminal funding or SFAS 106 amounts are reasonable.	DCMA	
2.	For accrual accounting other than terminal funding verify that:		
a.	The cost is measured and assigned in accordance with SFAS 106. (FAR 31.205-6(o)(2)(iii))	DCMA	
b.	The assigned cost is funded by the time set for filing the Federal income tax return. (FAR 31.205-6(o)(3))	DCMA or DCAA	
c.	If the contractor does not contribute funds to the PRB trust within 30 days of each quarter, the amount of increased costs caused by the delay in funding is excluded from claimed PRB costs. (FAR 31.205-6(o)(4))	DCMA or DCAA	
d.	The amount added to the fund is not greater than an amount required to apportion the cost of the insurance coverage fairly over the working lives of the active employees in the plan. (CAS 416.50(a)(1)(v)(C))	DCAA with DCMA tech. asst.	
3.	Ensure that the contractor has no right of recapture of the reserve or fund as long as any active or retired participant remains alive, unless the interests of such remaining participants are satisfied through adequate reinsurance or otherwise. (CAS 416.50(a)(1)(v)(B))	DCAA	
4.	If moneys do revert or inure to the contractor, ensure that the Government receives an equitable share of the credit calculated in accordance with FAR 31-205-6(o)(6).	DCMA or DCAA	
5.	If the contractor uses pension assets to fund PRB costs, ensure that the Government receives a credit (i.e., that PRB costs are reduced by the amount funded by pension assets) and that the contractor established an advance agreement with the Government to permit PRB costs to be paid using pension assets. (FAR 31-205-6(j)(3)(v))	DCMA or DCAA	

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6. If the contractor uses a terminal funded plan, verify that the actuarial present value of benefits at retirement are amortized over 15 years. (CAS 416.50(a)(1)(v)(C))	DCAA with DCMA tech. asst.	
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<b>I-1</b>	<b>Workers' Compensation – General</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
This insurance is to provide the contractor's employees with insurance coverage for job-related injuries and illnesses. Coverage can be purchased or obtained through self-insurance.		
A purchased plan for workers' compensation insurance is usually retrospectively rated (that is retroactive adjustments are made to the insurance carrier after the policy year ends). These retrospectively rated policies can be "group rated" (on the basis of tables or schedules) or "experience rated" (i.e., on the contractor's experience).		
1. Determine whether the contractor purchases workers' compensation insurance or is self-insured. If the contractor purchases workers' compensation insurance, determine if the plan is a "group retrospectively rated" plan or an "experience retrospectively rated" plan.		
2. Regardless of whether the contractor purchases the insurance or is self-insured, a program to reduce workplace mishaps is essential to the reduction of compensation costs. Therefore, the auditor should ascertain whether the contractor has initiated such a program. If not, the audit report should obtain appropriate recommendations for the establishment of such a program.		
3. Each state has its own worker's compensation laws. As such, the auditor must determine if contract charges for workers' compensation are in accordance with the laws of the contractor's applicable state of business.		

<b>J-1</b>	<b>Workers' Compensation – Purchased Insurance, Group Rated Plans</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
1. Costs for group rated plans are based on the number of employees by job classification. The insurance carrier will perform an audit to determine annual costs. The auditor should obtain a copy of this report and analyze its content. The reports will disclose job		

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<p>classifications used, composition of reserves, and calculation of actual costs. Using these reports, the DCAA auditor can compare the proposed costs to actual costs and identify any discrepancies that require additional audit coverage.</p>	
<p>2. Determine if the proper job classifications are being used. Compare the job classifications and related rates used by the insurance company auditor to compute the annual premium, to the job classifications used by the contractor to estimate costs for proposal purposes. Discuss any difference with the contractor. If the contractor cannot adequately explain the differences, the amount in excess of that determined by application of the contractor's bidding system job classifications to the rates outlined in the policy for those classifications should be questioned.</p>	
<p>3. Billings are assessed based on levels of payouts. These levels are detailed in the policy and should be evaluated and compared to the insurance cost charged to Government contracts. Any unexplained difference should be questioned.</p>	
<p>4. Determine that credits (e.g., return of part of the reserve) due are properly applied to decrease the insurance expense. The auditor may need to use a confirmation to the insurance carrier to determine if a credit has been paid to the contractor.</p>	
<p>5. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)).</p>	

<b>K-1</b>	<b>Workers' Compensation – Purchased Insurance, Experience Rated Plans</b>	<b>WP Reference</b>
	<b>Version 2.0, dated April 2004</b>	
	<p>Experience retrospectively rated plans are computed based on the contractor's actual losses. The initial charge is comprised of the insurance company's profit, overhead and "excess coverage" for losses in excess of the retrospective rated policy limits. When claims are paid by the insurance company, the contractor is charged for the claim amount plus a claims handling charge.</p>	
	<p>1. Determine that the contractor's projected average loss computation conforms with the fundamental requirement in CAS 416.40(a). Determine whether the projected average loss varies from the annual payment to the insurance carrier. (Normally any variance is associated with "Cash Management Plans.")</p>	
	<p>2. Under cash management plans, the financing provisions are negotiated. The reserve may be held by the contractor in total, or</p>	

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<p>split between the contractor and the insurance carrier. Since these plans are negotiated, there are no "standard" terms available for audit comparison purposes. Determine if the reserve or deposit held by the insurance carrier is properly discounted. Any excess reserve or deposit charges should be questioned accordingly. In addition, determine if any income or rebate is credited to the insurance expense as required by CAS 416.50(a)(1)(i). If not, question the amount of the dividend or rebate.</p>	
<p>3. In consideration of item 9 of the Prefatory Comments to CAS 416, any funds accrued for retrospective adjustments should be considered self-insurance subject to present value discounting. Therefore, all reserves maintained by contractors under purchased plans should be discounted using the Treasury Rate (CAS 416.50(a)(3)(ii)).</p>	
<p>4. Determine if competitive quotations are solicited. Are they used to determine the reasonableness of the proposed costs? If obtained but not used, determine reasons.</p>	
<p>5. To project insurance costs, contractors use development factors applied to paid losses and known claims. These factors are furnished by the insurance carrier to provide for estimated increases in claims for various reasons. Audit of these factors should include the following</p>	
<p>a. Verify prior year payouts and known claims to the listing provided by the insurance carrier.</p>	
<p>b. Verify claimed escalation on prior payouts and known claims to medical escalation indices (BLS indices).</p>	
<p>c. Evaluate claims growth amounts for higher settlements due to changes in economic environment and increasing number of claims filed each year. Compare the projected amount to experience for the past three years. Coordinate with the CIPR team captain regarding statistics that the auditor may use to evaluate claims growth.</p>	
<p>d. Unknown claims that are incurred but not reported (IBNR), should be identified as to specific reason or purpose (e.g., asbestos, other occupational illnesses, etc.). Consider the purpose for the IBNR, the contractor's loss experience for the IBNR claims, and other documentation. IBNRs are contingent in nature and subject to the provisions of FAR 31.205-7, "Contingencies." Accordingly, any highly speculative loss projections should be questioned</p>	
<p>6. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b).) Contractor loss experience by segment is particularly important in</p>	

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evaluating this cost allocation.	
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<b>L-1</b>	<b>Workers' Compensation – Self-Insurance Plans</b>	<b>WP Reference</b>
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1.	Evaluate the contractor's computation of the projected average loss. The projected average loss is computed either (a) on the basis of actual losses, that is current payouts plus known losses as defined by CAS 416.40(a), (b) current payouts, known losses and unknown losses (IBNRs), or (c) known losses and unknown losses (IBNRs) plus a retrospective adjustment computed annually for "missed" accruals for prior periods. [Note: IBNRs are contingent in nature and should be considered in accordance with FAR 31.205-7.]	
2.	Compare the projected average loss to prior year projections and payouts. If the reserve for incurred losses to be paid in future years is increasing, the contractor is estimating more costs than are currently being paid to claimants. Determine the reason and basis for the increasing difference between estimated costs and cash paid to claimants. Question excessive unsupported reserves. Coordination with the CIPR team captain requesting technical assistance may be required to determine whether the reserve is in excess of requirements.	
3.	If the contractor is including retrospective adjustments in its calculation of projected average loss, determine whether the adjustments (to adjust estimates to actual) are normal or are for missed accruals. Large adjustments usually represent missed accruals. Missed accruals represent an out-of-period adjustment which is contrary to the fundamental requirement of CAS 416.40(a) and should be questioned. Normal revisions to adjust accruals to actuals are allowable.	
4.	Determine if the contractor is present value discounting any reserve held in excess of one year as required by CAS 416.50(a)(3)(ii) and that Government contracts are both receiving and retaining the full value of the discount increments. Ascertain if the discount rate used is the interest rate determined by the Secretary of Treasury in effect at the time the loss is recognized in accordance with FAR 31.205-19(a)(3). Any difference resulting from the use of an interest rate other than the one required by FAR 31.205-19(a)(3) should be questioned accordingly. Compare available reserve amounts with actual expenditures to assure that the Government is retaining full value for the discounted amounts.	

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<p>5. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)). Contractor loss experience by segment is particularly important in evaluating this cost allocation.</p>	
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<b>M-1</b>	<b>General Liability</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
This is insurance to cover the contractor for losses due to third party accidents involving the contractor's property.		
1.	Determine whether the projected average loss is measured in accordance with CAS 416.40 and is based on purchased insurance, self-insurance estimates, or a combination of purchased and self-insurance. Compare projected average loss to prior estimates. Obtain explanation for any large fluctuations.	
2.	If insurance is purchased, assess the policy. Most policies have a high deductible which varies from \$1 million downward. Verify the premium amount to the insurance costs charged to Government contracts. Question any self-insurance cost for risks of catastrophic losses, since FAR 31.205-19(e) prohibits any such self-insurance charges .	
3.	Determine that year-end adjustments and dividends are properly credited and allocated to divisions and/or pools. The auditor may need to use a confirmation to the insurance carrier to determine if a credit has been paid to the contractor.	
4.	Analyze all reserves associated with retrospective rated policies. The reserve should be identified to specific potential losses (pending litigation). Determine that the reserve is appropriately present value discounted using the Treasury Rates.	
5.	Companies are "self-insured" for the deductible portion of the policy. Under CAS 416, an absence of insurance is interpreted as self-insurance. Some companies charge actual loss experience while others have formalized self-insurance programs. The use of actual loss experience is acceptable only for insignificant insurance costs. [FAR 31.205-19(a)(3)]	
6.	Determine whether the contractor obtains quotations from insurance brokers to estimate the self-insurance cost. These broker quotations are for insurance policies that are normally not written due to the high monetary risk involved. When encountering the broker quotation bidding technique the following audit steps should be	

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used.	
a. Evaluate the broker quotation.	
b. Determine if competitive quotations have been obtained.	
c. If competitive quotations have been solicited, is there a wide range of price fluctuation? Experience has disclosed a significant fluctuation between quotations when more than one is obtained. A wide range of prices tends to decrease the value of the competitiveness of the quotations. The quotations are usually not reflective of loss experience, and therefore, should not be used without a comparison to loss experience.	
d. Evaluate loss experience for an extended period (3 to 5 years). Compare loss experience to determine the reasonableness of the quotation.	
e. When a broker's quotation is used, the auditor must determine if the contractor's actual loss experience has been evaluated regularly and that any self-insurance charges reflect experience in the same manner as would purchased insurance (CAS 416(a)(2)(i)). Contractors using broker quotations sometimes do not adjust the next year's premium for any difference between the quoted amount and losses paid. Contractors normally cite CAS 416.50 (a)(2)(i) as the basis for not adjusting for the previous year's loss experience, and maintain that the proposed insurance cost is computed in the same manner as purchased insurance is computed; therefore, any "loss or profit" (that is, loss experience differing from the premium) belongs to the contractor in the same manner as it would belong to the insurance company had the contractor purchased the insurance coverage. DCAA has taken the position that loss experience must be used in computing the cost for this insurance. Any significant difference between the proposed and the actual loss experience should be reflected in the next year's projected average loss computation.	
[Note: This estimating method is applicable to any insurance coverage having deductibles or coinsurance, and these steps should be applied to all such insurance coverage.]	
7. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)).	

<b>N-1</b>	<b>Product Liability and Professional Liability Insurance</b>	<b>WP Reference</b>
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<p><b>Version 2.0, dated April 2004</b></p>	
<p><b>Product Liability and Professional Liability Insurance can also be referred to as Architects and Engineers or Errors and Omissions Insurance.</b> These types of coverage are to cover risk of loss to third parties due to damages incurred from the contractor's product or actions. The cost of insurance to protect the contractor against the costs of correcting its own defects in materials or workmanship is unallowable, while insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense (FAR 31.205-19(a)(4)).</p>	
<p>1. Normally product or professional liability insurance is purchased insurance due to the substantial risk involved should a loss be incurred. If a self-insured product or professional liability program is established, the ACO should be notified immediately to determine if the potential risk of loss would have any impact on the Government contracts. Under FAR 28, the ACO is required to approve most self-insured programs and make a determination that the risk of loss is adequately covered to allow the contractor to complete the contract.</p>	
<p>2. Determine whether the proposed cost is computed in accordance with CAS 416.40(a) and 416.50(a). Compare the proposed cost to the insurance policy and obtain explanations for any differences.</p>	
<p>3. Determine whether the costs are reasonable and allocable:</p>	
<p>a. Evaluate the policy coverage. If a contractor's liability insurance policy provides coverage for its general practice, allocation of premiums to all contracts through overhead or general and administrative expense is usually acceptable. However, if the policy is written to provide unique liability coverage for a particular business segment or product, costs should be directly allocated to the benefiting cost objective. Where a plain reading of the policy does not clearly establish the general nature of coverage or the auditor has reason to believe that unique liability coverage is involved, an examination of the types of services rendered to both the Government and commercial customers should be performed.</p>	
<p>b. Determine if the contractor provides the same service to the Government as to commercial customers. If the contractor does not provide the same service to the Government as to the commercial customers, then the auditor should evaluate the claims and loss experience. If a significant number of claims are the result of a particular product, segment, customer, etc., evaluate the nature of the service and projects causing the claims disparity to determine if there is a more appropriate allocation base. Items evaluated should include the number of</p>	

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settled and pending claims, whether they apply to Government or commercial contracts, and the dollar amounts.	
c. If aircraft product liability insurance is allocated on a sales base to Government contracts, evaluate for compliance with CAS 403.40(b)(4) and 403.60(b) if a home office, and CAS 410.50(g)(2) if an operating segment.	
4. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)).	

<b>O-1</b>	<b>Fire Insurance</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
1.	Determine if the contractor has a self-insurance plan, a purchased plan, or a combination self-insurance and purchased plan. Determine whether the proposed cost is computed in accordance with CAS 416.40(a) and 416.50(a).	
2.	If the insurance is purchased, evaluate the policy to determine any special provisions affecting the cost or cash flow. Compare the amount detailed in the policy to the amount charged to Government contracts, and obtain explanations for any differences. Any unexplained difference should be questioned.	
3.	Determine whether there are co-insurance or deductible provisions. If the contractor charges actual losses to the Government contracts, make sure this procedure conforms with FAR 31.205-19(a)(3) and CAS 416.50(a)(2)(ii). If the brokers quote technique described in the General Liability section of the audit program is employed, evaluate as appropriate.	
4.	Some policies require that a multi-year premium be paid when the policy starts. Rather than paying this advance payment, some contractors elect to pay the premium in annual installments. For this election privilege, the contractor is assessed an interest charge. Determine that this interest assessment is eliminated from the fire insurance charge included in the insurance cost charged to Government contracts.	
5.	If the contractor has a self-insurance program, determine that the reserve is properly discounted in accordance with CAS 416.50(a)(3)(ii). See working paper L-1, step 4 for audit guidance.	
6.	Determine if any credits, rebates, or other income have been appropriately allocated to Government contracts. The auditor may need to use a confirmation to the insurance carrier to determine if a	

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credit has been paid to the contractor.	
7. Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)).	

<b>P-1</b>	<b>Business Interruption Insurance</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
1.	FAR 31.205-19(e) states that any self-insurance charges for risks of catastrophic losses are unallowable. Business interruptions would be included in the catastrophic loss category. Therefore, business interruption insurance, to be allowable, must be purchased insurance.	
2.	Evaluate the purchased policy to ascertain that all profit insurance has been eliminated from the insurance costs charged to Government contracts (FAR 31-205.19(a)(2)(ii)).	
3.	Any difference between the premium per the policy, less the provision for profit, and the amount charged to Government contracts must be explained.	
4.	Determine whether insurance costs are allocated to cost objectives based on causal or beneficial relationships (CAS 416.40(b)).	

<b>Q-1</b>	<b>Insurance on Lives of Officers and Owners</b>	<b>WP Reference</b>
<b>Version 2.0, dated April 2004</b>		
1.	Costs of insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation, (see FAR 31.205-19(a)(2)(vi)). Evaluate the insurance policies of such insurance to determine who the beneficiaries are on the policy.	
2.	If the company or its owners are the beneficiaries, the costs do not represent additional compensation and are unallowable.	
3.	If the executive’s family and estate are the beneficiaries, the costs are allowable if the total compensation paid to the executive is reasonable.	

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A-1	Concluding Steps	Responsible Agency	WP Reference
<b>Version 2.0, dated April 2004</b>			
	1. Summarize any non-compliant practices. Discuss the findings with the team members and develop a unified Government position.	DCAA	
	2. Coordinate with team members the issuance of DCAA CAS compliance or non-compliance report to the Contracting Officer. When no instances of noncompliance are found the DCAA report should be issued under activity code 19416. When instances of noncompliance are found, the DCAA report should be issued under activity code 19200 in accordance with CAM 10-808.	DCAA	
	3. Update the permanent file.	DCAA	
	4. Prepare draft review/audit report. The non lead agency will report their review or audit results to the team leader. The team leader will issue a joint report to the ACO and copy each team member.	DCMA and DCAA	
	5. Discuss the results of the review/audit with the contractor. Provide a copy of the draft joint report to the contractor for comment.	DCMA and DCAA	
	6. Finalize and issue the joint-review report. Provide copy of final joint-review report to each team member or agency.	DCMA and DCCAA	
	7. The team leader will follow up on joint-review/audit recommendations with the ACO and provide supplemental assistance.	Team Leader	
	8. 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 (e.g., by initials and date on the CD or working paper folder, etc.) and should include:	DCAA	
	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.	DCAA	
	b. Review the APPS exe file for size. APPS-generated executable files that are over 10 megabytes in size	DCAA	

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<p>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>	DCAA	
<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>	DCAA	
<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>	DCAA	
<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>	DCAA	
<p>g. Ensure an electronic copy of the final draft audit</p>	DCAA	

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<p>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 changes (spelling, format, etc.) made during final processing.</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>	DCAA	
<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>	DCAA	
<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>	DCAA	
<p>k. Securely enclose the “backup” set of electronic files (CD) and any “official” set of hard copy in the hard copy folder.</p>	DCAA	
<p>l. File the “official” set of electronic files in iRIMS (see iRIMS User Guide).</p>	DCAA	
<p>m. <b><u>Do Not File Sensitive Audits in iRIMS:</u></b> Sensitive audits include but are not limited to classified work, suspected irregular conduct, 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>	DCAA	