

MASTER AUDIT PROGRAM

Activity Code 19418	Compliance Audit CAS 418
B-1 Planning Considerations	Version 6.0, dated July 2020

Type of Service - Attestation Examination Engagement

Audit Specific Independence Determination

Members of the audit team and internal specialists consulting on this audit must complete the Audit Specific Independence Determination (WP 34) prior to starting any work on this assignment.

(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 working paper. For example, an FAO may add additional auditors (e.g., technical specialists) 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.)

Purpose and Scope

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 418 requires the consistent classification of costs as direct or indirect, establishes criteria for accumulating indirect costs in indirect cost pools, and provides guidance on allocating indirect cost pools. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 418 criteria (48 CFR 9904.418).
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 418. The audit steps in the program should reflect a documented understanding between the auditor and 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

1. Before beginning any CAS compliance audit, the auditor should first determine if the contractor is subject to the CAS coverage. If the standard is not applicable to the contractor, the audit should be cancelled.
2. Materiality (see 48 CFR 9903.305) and audit risk assessment are also integral parts of the planning process and should be considered in developing the extent of CAS compliance tests.
3. Once it is determined that CAS 418 is applicable, the auditor should assess:

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Other Planning Considerations
4. which provisions of the standard are significant to the contractor. The decision to not test specific provisions of the standard for compliance should be documented.
5. control risk; and
6. the results of relevant other audits (e.g., results of prior compliance audits, Disclosure Statement revisions, etc.)
7. Prior to commencing the audit, review Agency guidance that may impact the audit and adjust the scope and procedures appropriately.

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B-1 Preliminary Steps	WP Reference
Version 6.0, dated July 2020	
1. Research and Planning	
a. Read and become familiar with the criteria in CAS 418. Identify any changes in the CAS 418 standard since the last examination.	
b. Evaluate Parts III and IV of the contractor's Disclosure Statement to become familiar with the disclosed accounting practices. Document any ambiguities, vague descriptions, etc. Determine if the contractor's accounting system has remained unchanged since the last CAS 418 compliance audit.	
c. If changes have occurred, adjust audit scope accordingly.	
d. Evaluate recent forward pricing or incurred cost proposals to:	
(1) Evaluate recent forward pricing or incurred cost proposals to determine whether total costs subject to CAS 418 are material. Consider contractor's sales mix (i.e., CAS-covered Government contracts vs. non-CAS-covered and commercial) when determining materiality of costs subject to this standard. Materiality should be a consideration only in determining the extent of substantive testing.	
(2) Determine if the contractor has pre-established rates as described in CAS 418.50(g). If so, discuss impact of reduced risk with the technical specialist/supervisory auditor.	
e. Examine other FAO permanent file data (e.g. relevant audit leads) 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.	
f. Review permanent file to determine if previous audits included findings and recommendations that relate to the subject matter. If there were findings material to the subject matter, document this information in the risk assessment and perform the following procedures:	
(1) 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. (GAGAS 7.13) (2) Document the results of the inquiry and the impact of the corrective actions to the subject matter.	

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B-1 Preliminary Steps	WP Reference
<p data-bbox="256 237 1218 415">g. Review permanent file to determine if the contractor has previously provided other studies or audits (e.g., summary listing of internal audits or external audit reports) that directly relate to the subject matter. If there are no other studies or audits, document that information in the working papers and perform the procedures below.</p> <p data-bbox="305 432 1214 594">(1) 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.</p> <p data-bbox="305 604 1177 663">(2) If the review of the perm file or the contractor identifies relevant internal audits:</p> <ul data-bbox="354 674 1230 1188" 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 CAD 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 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 working papers. <p data-bbox="305 1199 1177 1260">(3) If the review of the perm file or the contractor identifies relevant other audits or studies:</p> <ul data-bbox="354 1287 1198 1392" 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.).	

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B-1 Preliminary Steps	WP Reference
<ul style="list-style-type: none"> • 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 the contractor 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 respond to identified risk.</p>	
<p>h. Determine if contractor has written policies and procedures that classify costs as direct or indirect. If not, adjust audit scope accordingly.</p>	
<p>i. If appropriate, coordinate with the FAO technical specialist, CAD, and/or regional specialist on matters of interpretation and policy.</p>	
<p>j. Contact the contracting officer to ascertain any known concerns that will impact the audit and adjust the audit scope and procedures accordingly.</p>	
<p>k. Notify the appropriate contracting officer of the commencement of the risk assessment and that the expected completion date will be provided in the formal acknowledgement once the risk assessment is complete. . The acknowledgement process should be performed in accordance with CAM 4-104.</p>	
<p>2. Entrance Conference</p>	
<p>a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on:</p>	
<p>(1) Confirm that Policies and Procedures are current.</p>	
<p>(2) Requesting the contractor's explanation of the internal control structure as related to CAS 418.</p>	
<p>(3) Any changes since the last audit.</p>	
<p>(4) The contractor's monitoring process for classifying costs.</p>	
<p>(5) Any identified weaknesses which may have been reported and related follow-up actions. If applicable, include a follow up with contractor management on:</p> <ul style="list-style-type: none"> • corrective actions that address previous DCAA audit findings and recommendations, • other studies or audits that impact the subject matter. 	
<p>b. If relying on the work of others follow the procedures in CAM 4-1000.</p>	

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B-1 Preliminary Steps	WP Reference
c. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.	
3. Risk Assessment Steps	
a. 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. Auditors should be able to obtain a major portion of this understanding during a walkthrough of the subject matter.	
b. 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 indirect pools/rates are significant and which, if any, are immaterial. (For immaterial pools/rates, discuss with the technical specialist and/or the supervisory auditor prior to performing additional effort.)	
(2) For each significant indirect pool/rate, determine that actual cost elements included in each pool and allocation base are consistent with Disclosure Statement.	
(3) Determine whether recent incurred cost or forward pricing audits included reclassification of costs between pools, or between direct and indirect costs.	
(4) Compare the pools/bases to the disclosure statement to determine if any changes have been made to any accounting practices.	
(5) Determine provisions of the standard that are material.	

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B-1 Preliminary Steps	WP Reference
<p>c. During the entrance conference, or other appropriate meeting, make specific inquiries of contractor management and other appropriate parties regarding the following:</p> <ol style="list-style-type: none"><li data-bbox="305 363 1177 506">(1) Their knowledge of any actual, suspected, or alleged fraud or noncompliance with laws and regulations affecting the period of time corresponding to the subject matter under audit. (AT-C 205.32)<li data-bbox="305 527 1222 669">(2) Whether any investigations or legal proceedings, that are significant to the engagement objectives, have been initiated or are in process with respect to the period of time corresponding to the subject matter. (GAGAS 7.14)<li data-bbox="305 690 1211 863">(3) The existence of other audits and studies (performed by other than DCAA) that relate to the subject matter under audit. If yes, have the contractor explain the audits and studies performed, any related findings or recommendations, and any contractor corrective actions taken. (GAGAS 7.13) <p><i>Note: Specifically document in the working papers; the inquiries and the corresponding responses as well as how the responses affect the performance of the engagement.</i></p>	

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B-1 Preliminary Steps	WP Reference
<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 material noncompliances, whether due to error or fraud, that could 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 accounting system deficiencies), • relevant aspects of the contractor and its environment, • risk of material noncompliance due to fraud (e.g., the extent of financial incentives, pressures to meet budgetary and contractual commitments, and opportunities to commit and conceal fraud). Consider the fraud risk factors and scenarios presented in the DoD OIG's webpage: Fraud Detection Resources for Auditors. Copy link and paste into web browser, • other known risk factors identified that could materially affect the subject matter, • the audit team's understanding of relevant key internal controls. Document the factors identified that increase the risk of material noncompliance due to error or fraud that could affect the subject matter, and design audit procedures to respond to the increased risk of material noncompliance. <p>Communication among audit team members should continue as needed throughout the audit regarding the risk of misstatement and noncompliance due to error or fraud.</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>	

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C-1 Determination of Direct and Indirect Cost	WP Reference
Version 6.0, dated July 2020	
1. Evaluate the contractor's written statements of accounting policies and procedures and determine that they adequately classify costs as direct or indirect (CAS 418.40(a)).	
a. The information disclosed by the contractor in its Disclosure Statement may be sufficient to make this determination. It should be considered before requesting additional information.	
b. Determine whether the written statements comply with the requirements of the standard as detailed in subsequent steps.	
c. Evaluate the accounting for direct costs to determine that actual costs are used, except that:	
d. Standard costs may be used for direct labor and material as provided in CAS 407 or CAS 418.50(a)(2)(i).	
e. An average or pre-established direct labor rate may be used (CAS 418.50(a)(2)(ii)).	
2. If average or pre-established direct labor rates are used, examine pay ranges within individual rate categories to determine whether the pay ranges are widely dispersed. If not widely dispersed, discuss with the technical specialist/supervisory auditor before continuing the audit effort on labor rates.	
3. If pay ranges are widely dispersed, determine if the functions performed are not materially disparate and the employees are interchangeable with respect to the function by:	
a. Evaluating job descriptions	
b. Employee Interviews, and/or	
c. Requesting specialist assistance, if necessary	
4. If the functions performed are disparate, determine if the employees either work in a single production unit yielding homogeneous outputs or perform their functions as an integral team.	
5. Evaluate the contractor's written policies and procedures and/or variance reports to determine if the variance between the average or pre-established direct labor rate and the actual rate for a cost accounting period, if material, are disposed of at least annually by allocation to cost objectives in proportion to the costs previously allocated to these cost objectives.	
6. Determine that any labor and material costs are accounted for as direct labor and material when such costs are specifically identified to any of the following cost objectives (CAS 418.50(a)(3)):	
a. Final cost objectives;	

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C-1 Determination of Direct and Indirect Cost	WP Reference
b. Goods produced for stock or product inventory;	
c. Independent research and development and bid and proposal projects;	
d. Cost centers for accumulating costs identified with a process cost system (i.e., process cost centers);	
e. Goods or services produced or acquired for other segments of the contractor and for other cost objectives of a business unit; and	
f. Self-construction, fabrication, betterment, improvement, or installation of tangible capital assets.	
7. Determine if the contractor has changed its practices for charging or classifying costs as direct/indirect costs. Test the contractor's practices for classification of direct vs. indirect costs. Discuss with the technical specialist/supervisory auditor a sampling plan to test/verify proper classification of direct/indirect costs. (MAARs 7 and 10)	

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D-1 Indirect Cost Pools (MAAR 16)	WP Reference
Version 6.0, dated July 2020	
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 significant indirect expense pools including service center pools.	
2. Analyze significant activities (considering disclosed descriptions of major functions and activities, descriptions of functional departments/codes, etc.) included in each pool identified in step 1. above and determine that the indirect cost pools are homogeneous based on the following criteria. (CAS 418.50(b)(1)):	
a. All significant activities of the cost pool have the same or similar beneficial or causal relationship to cost objectives, <u>or</u>	
b. The separate allocation of costs of dissimilar activities would not result in a materially different allocation. The determination of materiality shall be made using the criteria provided in 48 CFR 9903.305 (CAS 418.50(b)(2)).	
c. Apparent non-homogeneous expense elements/activities should be evaluated in detail to determine if they meet one of the two homogeneity criteria described in (1) and (2) above.	
3. Determine that the homogeneous cost pool includes all the indirect costs identified with the activity to which the pool relates. (CAS 418.50(b)(3)).	

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E-1 Allocation Bases for Indirect Cost Pools (MAAR 18)	WP Reference
Version 6.0, dated July 2020	
1. Analyze the indirect cost pools to determine whether:	
a. They include material amounts of costs for the management or supervision of activities involving direct labor or direct material costs. These will normally be those pools which relate to indirect costs, such as fabrication, production, manufacturing, engineering, etc. for a product or program, e.g., manufacturing, engineering, material overhead pools (CAS 418.50(d)), <u>or</u>	
b. They do not include material amounts of costs for the management or supervision of activities involving direct labor or material costs. These will normally be those pools, which relate to indirect costs, such as service centers and other intermediate indirect pools (CAS 418.50(e)).	
2. For the indirect pools identified in Step E-1 1.a. above, determine that the contractor has selected one of the following allocation bases which represent the activity managed or supervised:	
a. Direct labor hour or dollar base - whichever is likely to vary in proportion to the costs included in the pool (CAS 418.50(d)(2)(i));	
b. The machine hour base is appropriate when the pool costs are predominantly facility related costs, such as depreciation, maintenance and utilities (CAS 418.50(d)(2)(ii));	
c. The unit of production base is appropriate when there is a production of comparable units (CAS 418.50(d)(2)(iii));	
d. The material cost base is appropriate when the activity being managed or supervised is a material related activity (CAS 418.50(d)(2)(iv)).	
e. Analyze detail breakdown of costs included in the allocation base and determine that the appropriate base selected under steps E-1, 2.a-d. above includes all significant elements of the selected base (e.g., overtime hours included in the direct labor hours base.);	
f. Analyze detail breakdown of cost objectives included in the allocation base and determine indirect cost pools are allocated to: (CAS 418.50(d)(3))	
<ul style="list-style-type: none"> • Final cost objectives. 	
<ul style="list-style-type: none"> • Goods produced for stock or product inventory. 	
<ul style="list-style-type: none"> • IR&D/B&P projects. 	
<ul style="list-style-type: none"> • Process cost centers. 	
<ul style="list-style-type: none"> • Goods or services produced or acquired for other segments of the contractor and for other cost objectives of the business unit. 	

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E-1 Allocation Bases for Indirect Cost Pools (MAAR 18)	WP Reference
<ul style="list-style-type: none"> • Self construction, fabrication, betterment, improvement, or installation of tangible capital assets. 	
<p>3. For those indirect pools identified in step E-1 1.b. above, determine that the contractor has selected a base which allocates the pooled costs using an appropriate measure of resource consumption. This determination will be made in accordance with the following hierarchy of acceptable methods (CAS 418.50(e)):</p>	
<p>a. The resource consumption of the activities of the indirect pool. Examples include: machine usage hours (computer or reproduction equipment), or flight hours (company aircraft) (CAS 418.50(e)(1)).</p>	
<p>b. The output of the activity of the indirect pool, if resource consumption measures are unavailable or impractical to ascertain. Output is usually measured in terms of the units of end product of the activity such as number of printed pages (reproduction), number of reports (computer center), etc. (CAS 418.50(e)(2)(i)).</p> <p>When the level of resource consumption varies among the units of output, and a material difference would result, the output measure should be modified or more than one output measure should be used to reflect the resources consumed to perform the activity (CAS 418.50(e)(2)(ii)).</p>	
<p>c. A surrogate which measures the activity of the cost objectives receiving the service is used only when neither the resources consumed nor the output of the activities can be measured practically. An example is the number of requisitions received from each requesting activity for reproduction or computer service effort (CAS 418.50(e)(3)).</p>	
<p>d. When the allocation(s) of indirect pools benefit one another, determine that the following acceptable allocation methods are used: (1) cross allocation, (2) sequential or (3) another method which produces results comparable to methods (1) and (2) (CAS 418.50(e)(4)).</p>	
<p>e. When services are provided simultaneously to two or more cost objectives, determine that the costs of the services are prorated among the cost objectives in reasonable proportion to the beneficial or causal relationship between the service performed and the cost objectives (CAS 418.50(e)(5)).</p>	

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E-1 Allocation Bases for Indirect Cost Pools (MAAR 18)	WP Reference
<p>4. Prior to recommending any changes to the contractor's existing allocation methods the auditor must first compute and analyze the allocations to final cost objectives which result from the use of the appropriate base in accordance with steps E-1 2. and E-1 3. above. A comparison of such allocations will be made with those allocations using the existing base. Only when the comparison results in a material difference in the allocations to final cost objectives will a recommendation be made to change the allocation base.</p>	
<p>5. Determine whether the contractor has made any special allocation of indirect costs. If yes, determine (CAS 418.50(f)):</p>	
<p>a. If a particular cost objective receives significantly more or less benefit than would be reflected by the use of an acceptable base under CAS 418.</p>	
<p>b. Whether the Government has agreed to the special allocation. If not, notify the CFAO.</p>	
<p>c. When a special allocation is made pursuant to an agreement, determine if the amount of the special allocation is removed from the indirect cost pool and the particular cost objective's base data from the base used to allocate the indirect cost pool.</p>	
<p>6. Verify that the contractor properly calculates rates for each indirect pool. (MAAR 19)</p>	
<p>7. If pre-established rates are used in the allocation of an indirect cost pool, evaluate the contractor's policy, detailed calculation of the rates, and/or variance report to determine: (MAAR 19)</p>	
<p>a. The pre-established rates reflect all costs and activities anticipated for a cost accounting period (CAS 418.50(g)(2)).</p>	
<p>b. The rates are evaluated at least annually and revised as necessary to reflect the anticipated conditions. Such revisions may be made at the beginning or during the cost accounting period. In either case, the revisions should reflect the cost and activities for the entire cost accounting period (CAS 418.50(g)(2)).</p> <p>When revisions are made during a cost accounting period, the prior allocation of costs is adjusted to reflect the revised costs if the accumulated variance between the original and revised rate is significant (CAS 418.50(g)(5)).</p>	
<p>c. The variances are disposed at least annually (see 418.50(g)(2) and (g)(5)) by allocating it to cost objectives in proportion to the costs previously allocated to the cost objectives by use of the pre-established rates. (CAS 418.50(g)(4)). (MAAR 10)</p>	

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E-1 Allocation Bases for Indirect Cost Pools (MAAR 18)	WP Reference
d. The contracting parties may agree to use pre-established rates in allocating indirect costs pools which are not based on cost accounting periods. When applicable, determine that the contractor has written policies for the establishment of the rates and the policies are consistently applied.	

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A-1 Concluding Steps	WP Reference
Version 6.0, dated July 2020	
1. Summarize and document the results of audit.	
<p>2. Discuss the audit results with 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 CAD network (see CAM 8-302.4 and 8-302.6). Coordination should be both before and after discussion of audit results with the contractor. The CFAO should be apprised of noncompliance matters at the earliest possible date.</p> <p><i>Note: If a noncompliance is considered immaterial, but could become material if circumstances change, notify the CFAO through a memorandum. The memorandum will include a Statement of Condition and Recommendation (SOCAR) and provide the CFAO with sufficient 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.</i></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 WP A01) and Opinion (from WP A) section of the report, as necessary, so that they clearly identify the limited areas audited.	
4. If a material weakness or significant internal control deficiency is detected during the course of this audit, ensure that the findings have been fully developed to determine if a significant deficiency in compliance with the DFARS 252.242-7006 criteria exists. If so, open a Business System Deficiency assignment (Activity Code 11090) to report the deficiency and submit it to the contractor for comment.	
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.	
6. Finalize audit report (and memorandum, if applicable) incorporating the contractor's reaction and auditor's response, if applicable.	

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A-1 Concluding Steps	WP Reference
7. Complete the administrative working papers.	
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 files after the assignment has been closed in DMIS.</i>	
9. Submit the working paper package and draft report (and memorandum, if applicable) to the supervisor/manager for final review and processing.	