

# MASTER AUDIT PROGRAM

<b>Activity Code 19407</b>	<b>Compliance Audit CAS 407</b>
<b>B-1 Planning Considerations</b>	<b>Version 8.4, dated Dec 2025</b>

<b>Type of Service - Attestation Examination Engagement</b>
<b>Audit Specific Independence Determination</b>
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.  <i>(Note: Because staff is sometimes added to on-going audits, supervisors should ensure that all individuals who are directing, performing audit procedures, or reporting on this audit as a member of the audit team who are performing as a consultant have signed this 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.)</i>

<b>Purpose and Scope</b>
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 407 establishes criteria under which standard costs may be used for estimating, accumulating, and reporting costs of direct material and direct labor. It also provides criteria relating to the establishment of standards, accumulation of standard costs, and the accumulation and disposition of variances from standard costs. The cost accounting standard is not intended to cover the use of pre-established measures solely for estimating. FAR 52.230-2, Cost Accounting Standards, requires the contractor to comply with the CAS 407 criteria.
2. The scope of this audit should be limited to the last completed contractor fiscal year. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms. The auditor, the technical specialist and/or the supervisory auditor should agree upon the level of transaction testing in setting the scope of the audit. This understanding should be documented in the working papers.
3. This program is intended to provide for the proper planning, performance, and reporting on the contractor's compliance with CAS 407. The audit steps in the program should reflect a documented understanding between the auditor and the technical specialist and/or the supervisor as to the scope required to comply in an efficient and effective manner with generally accepted auditing standards and DCAA objectives. The program steps are intended as general guidance and should be tailored as determined by audit risk.

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<b>Other Planning Considerations</b>	
1. Before beginning the audit, the auditor should first determine if the contractor is subject to CAS 407 coverage. Using the standard for Government contract costing is the contractor's option. Contractors are not required to establish standard cost accounting systems or use established standard cost accounting systems, intended for management purposes, for costing Government work. Furthermore, CAS 407 does not cover the use of pre-established measures used solely for estimating purposes. However, contractors are required to follow provisions of CAS 407 if they choose to cost Government contracts through a standard cost accounting system. 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 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 407 is applicable, the auditor should assess which provisions of the standard are significant to the contractor; assess control risk; and the results of other relevant audits (e.g., results of prior compliance audits, Disclosure Statement examinations, etc.). The decision to not test whether the contractor is complying with specific provisions of the standard should be documented.	
4. Prior to commencing the audit, review Agency guidance that may impact the audit and adjust the scope and procedures appropriately.	

<b>B-1 Preliminary Steps</b>	<b>WP Reference</b>
<b>Version 8.4, dated Dec 2025</b>	
1. Research and Planning	
a. Read and become familiar with the criteria in CAS 407. Identify any changes in the CAS 407 standard since the last examination.	
b. Evaluate Part II of the contractor's Disclosure Statement and related written policies and procedures to become familiar with the disclosed accounting practices. Determine if the contractor costs Government contracts through a standard cost system. That is, make an independent assessment whether the contractor is subject to CAS 407.	
c. Customarily, both components of a standard are stated at standard to derive cost at standard. Under CAS 407, if one element is at standard and one element is at actual, the result is considered cost at standard. For example, when either the material price or quantity is set at standard with the other component stated at actual, the resulting product is treated as material cost at standard and, therefore, is subject to CAS 407 (CAS 407.50(a)(2)).	
d. Determine if the contractor's accounting system has remained unchanged since the last CAS compliance audit. If changes have occurred, adjust audit scope accordingly.	

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B-1 Preliminary Steps	WP Reference
<p>e. 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:</p> <p>(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)</p> <p>(2) Document the results of the inquiry and the impact of the corrective actions to the subject matter.</p>	

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B-1 Preliminary Steps	WP Reference
<p>f. Review permanent file to determine if the contractor has previously provided other studies or audits (e.g., summary listing of internal audits or external audit reports) that directly relate to the subject matter. If there are no other studies or audits, document that information in the working papers and perform the procedures below.</p> <p>(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>(2) If the review of the perm file or the contractor identifies relevant internal audits:</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• Document the results of the determination in writing.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> </ul> <p>(3) If the review of the perm file or the contractor identifies relevant other audits or studies:</p> <ul style="list-style-type: none"> <li>• Obtain publicly available information for the relevant other Government agency audits (e.g., websites for DoD IG or other IGs, service audit agencies, etc.).</li> <li>▪ Make appropriate adjustments to your risk assessment and planned procedures based on the reported findings.</li> </ul> <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>	

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B-1 Preliminary Steps	WP Reference
g. Evaluate recent pricing proposals or incurred cost submissions to determine whether total standard costs 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.	
h. Examine the FAO permanent files, audit leads in EPIC, and prior audit work paper 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.	
i. If appropriate, coordinate with the FAO technical specialist, CAD, and/or regional specialist on matters of interpretation and policy.	
j. Contact the contracting officer to ascertain any known concerns that will impact the audit and adjust the audit scope and procedures accordingly.	
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.	
2. Entrance Conference	
a. Arrange and conduct an entrance conference covering the areas highlighted in CAM 4-302 with particular emphasis on:	
(1) Confirming whether or not the contractor is subject to CAS 407.	
(2) Requesting the contractor's explanation of the internal control structure for setting, revising, and using the standards, as well as disposition of the variances, including the contractor's variance analysis, corrective action, and applicable adjustments.	
(3) Requesting data to determine materiality of provisions of the standard.	
(4) Confirming whether any changes were made since the last audit.	
(5) Requesting the contractor to explain its monitoring process.	
(6) Requesting the contractor to identify all related written policies and procedures.	
(7) Requesting contractor to provide copies of any internal or external audit reports on CAS and/or its standard cost system.	

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B-1 Preliminary Steps	WP Reference
<p>(8) Discussing 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"> <li>• corrective actions that address previous DCAA audit findings and recommendations,</li> <li>• other studies or audits that impact the subject matter</li> </ul>	
b. If relying on the work of others follow the procedures in CAM 4-1000.	
c. Issue a notification letter to the contractor regarding the audit in accordance with CAM 4-302.3.	
3. Risk Assessment	
a. Obtain and document an understanding of contractor internal controls relevant to the audit. Auditors may obtain a significant portion of this understanding during the walkthrough.	
b. Determine and document:	
(1) the amount of direct labor and material costs subject to CAS 407 provisions (include open unaudited, current, and, if available, budgeted year(s));	
(2) impact of these costs on Government contracts by contract type;	
(3) amount of variances;	
(4) impact of the variances on Government contracts by contract type; and	
(5) Determine provisions of the standard that are material.	
c. Management Inquiries  During the entrance conference or other appropriate meeting make the GAGAS required inquiries of contractor management. Using the framework of WP B-05, document the contractor's response, and identify areas of risk and the impact to the audit scope.	B-05
d. Fraud Risk Indicators  Using the framework in WP B-09, discuss the fraud risk indicators with the audit team.	B-09
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.	

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B-1 Preliminary Steps	WP Reference
f. Discuss with the CAS Technical Specialist and/or Supervisory Auditor the scope of the audit. If the provision of the standard is not applicable or is immaterial, the audit should be curtailed. Document the decision to curtail the audit of the provision.	
g. Update the information in the permanent files as needed.	

C-1 Basic Requirements	WP Reference
<b>Version 8.4, dated Dec 2025</b>	
1. Use of a standard cost system to cost Government contracts is permitted only when it meets the criteria in CAS 407. Verify that these criteria are met by determining that standard costs are used only when:	
a. They are entered into the books of account (CAS 407.40(a)); (However, properly computed variances may be allocated by memorandum worksheet adjustments rather than entered into the books of account.)	
(1) Evaluate the contractor's accounting records and verify that standard costs are used to accumulate costs in the books and records.	
(2) Verify that variances are either entered into the books and records or allocated by memorandum worksheet adjustments.	
b. Standard costs and related variances are accounted for at the level of the production unit (CAS 407.40(b));	
(1) Determine what the contractor considers its "production unit" and whether its definition complies with CAS 407.30(a)(7).	
(2) Verify that standard costs and related variances are accounted for at the production level.	
(3) A production unit is a grouping of activities which either uses homogeneous inputs of direct material and direct labor or yields homogeneous outputs. Depending on the circumstances, contractors may meet the requirements of accumulating to the production unit level by accumulating costs: <ul style="list-style-type: none"> <li>• For all products in one grouping,</li> <li>• By product,</li> <li>• By assembly or subassembly, or</li> <li>• By part.</li> </ul>	
c. Practices for setting, revising, and using the standards, as well as the disposition of variances are stated in writing and consistently followed (CAS 407.40(c)).	

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C-1 Basic Requirements	WP Reference
2. Determine that the written statement of practices includes (CAS 407.50(a)(1)):	
a. The bases and criteria used in setting and revising standards. (CAS 407 does not establish the bases or criteria that should be used to establish or revise the particular standard. It requires that the basis chosen to develop or revise the particular standard be disclosed in writing. There are many bases and criteria; e.g., standard hours may be developed/revised using an engineering (time and motion) study or prior experience. Standards must be revised periodically so that they reflect current information.)	
b. The period during which standards are to remain effective. (For example, if the material price standard is meant to be used for only the first six months of the year, with a new standard to be developed for the last six months of the year then the contractor should so disclose that fact in its written practices. Ascertain if the procedure covers revised standards during a year and how the variance would be dispositioned.)	
c. The level at which material-quantity standards and labor-time standards are set, e.g., if the standard represents:	
(1) What the costs would be if operations were conducted at optimum efficiency, the result is an ideal standard.	
(2) The level of efficiency that can be reasonably expected under prevailing conditions, then the result is known as a normal or attainable standard.	
d. Conditions which material-price standards and labor rate standards are designed to reflect, e.g., conditions expected to prevail at the beginning of the year, throughout the year, or at the end of the year.	
3. Assess whether the written practices are adequate and consistently followed. Test the procedures to ensure standards and variances are recorded properly. If this was accomplished in prior audit assignments (e.g., proposal or forward pricing audits), cross reference to those audit assignments.	
4. Determine and document the reliability of the information the audit team will use to reach their conclusions in this section.	

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D-1 Standard Costs for Labor	WP Reference
<b>Version 8.4, dated Dec 2025</b>	
<p>1. Determine the basis for the labor standard(s) and determine whether the standard(s) is based on the classification of labor, department, product, etc. Once the production unit is identified, obtain a listing of labor rate standards by production unit. Sample the production unit to determine whether the labor rate standards meet the requirements of 2 or 3 below.</p>	
<p>2. When a labor-rate standard is set to cover a category of direct labor, determine that the functions performed within that category are not materially disparate and the employees involved are interchangeable with respect to the functions performed (CAS 407.50(a)(3)). Review job descriptions and interview employees if necessary. Obtain CAS technical specialist assistance as needed.</p>	
<p>3. When a labor-rate standard is set to cover a group of direct labor workers who perform disparate functions, determine that:</p>	
<p>a. The group of workers all work in a single production unit yielding homogeneous outputs; or</p>	
<p>b. The group of workers, in performance of their respective functions, forms an integral team (CAS 407.50(a)(4)).</p>	
<p>4. Compare the contractor's actual and disclosed practices for the labor cost variances. Verify that the actual and disclosed practices are consistent. Verify that labor-cost variances are recognized at the time labor cost is introduced into production units, i.e., when incurred. Labor-rate variances and labor-time variances may be separately accumulated or combined into one labor-cost variance account. Verify that a separate labor-cost variance is accumulated and distributed for each production unit (CAS 407.50(c)).</p>	
<p>5. Determine and document the reliability of the information the audit team will use to reach their conclusions in this section.</p>	

E-1 Standard Costs for Material	WP Reference
<b>Version 8.4, dated Dec 2025</b>	
<p>1. Verify that the actual and disclosed practices are consistent and comply with the following</p>	
<p>a. Material-price variances may be recognized at the time purchases are entered into the books of account or at the time costs are allocated to production units (CAS 407.50(b)(1)).</p>	
<p>b. Material-quantity variances are recognized at the point material costs are allocated to production units.</p>	

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E-1 Standard Costs for Material	WP Reference
2. Test variances actually recorded to verify that they are calculated properly (against correct standards) and distributed appropriately.	
3. When material-price standards are used and related price variances are recognized at the time the purchases of material are entered into the books of account:	
a. Determine that the material-price standards and related variances are accumulated separately by homogeneous groupings of material. A grouping is homogeneous if:	
(1) The prices of all items in that grouping of material are expected to fluctuate in the same direction and at substantially the same rate (CAS 407.50(b)(2)(i)) or	
(2) The items in that grouping of material are held for use in a single production unit yielding homogeneous outputs (CAS 407.50 (b)(2)(ii)).	
b. Verify that significant variances of each homogeneous grouping are allocated (CAS 407.50(b)(3)):	
(1) At least annually to items in purchased-item inventory and to production units receiving items from that homogeneous group of materials.	
(2) On the basis of standard cost of material received, by either:	
<ul style="list-style-type: none"> <li>• Adjusting the purchased-item inventory (ending inventory) from standard cost to actual cost, then allocating the balance of the price variance to production units on the basis of total standard cost received from the homogeneous grouping by each of the production units (CAS 407.50(b)(3)(i)), or</li> </ul>	
<ul style="list-style-type: none"> <li>• Treating the purchased-item inventory, collectively, as a production unit and allocating the price variance to production units on the basis of standard costs received by each production unit from that homogeneous grouping of material (CAS 407.50(b)(3)(ii)).</li> </ul>	
(3) Consistently, as required by the standard.	
c. Insignificant variances may be included in appropriate indirect cost pools; verify that variances included in indirect cost pools are immaterial. (CAS 407.50(b)(4))	

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E-1 Standard Costs for Material	WP Reference
4. When material-price variances are recognized at the time material cost is allocated to production units or when material-price variances are allocated to production units, the variances may be combined with material-quantity variances into one material cost variance for that production unit. If the contractor uses this method, verify that a separate material-cost variance is accumulated for each production unit (CAS 407.50(b)(5)).	
5. Determine and document the reliability of the information the audit team will use to reach their conclusions in this section.	

F-1 Disposition of Variances	WP Reference
<b>Version 8.4, dated Dec 2025</b>	
1. Determine that the contractor's established practices regarding the disposition of variances accumulated by production unit are in accordance with the following (CAS 407.50(d)):	
a. Significant variances must be allocated to cost objectives at least annually. The cost objectives include both finished goods inventory (contracts) and work-in-process inventory.	
(1) Where a variance related to material is allocated, the allocation shall be on the basis of the material cost at standard, or, where outputs are homogeneous, on the basis of units of output.	
(2) Variances related to labor shall be allocated on the basis of labor cost at standard, labor hours at standard, or where outputs are homogeneous, on the basis of units of output.	
b. Immaterial variances may be included in appropriate indirect cost pools for allocation to applicable cost objectives. If the contractor includes variances in indirect cost pools, verify that the variances are immaterial.	
2. Determine and document the reliability of the information the audit team will use to reach their conclusions in this section.	

A-1 Concluding Steps	WP Reference
<b>Version 8.4, dated Dec 2025</b>	
1. Summarize and document the results of audit.	

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A-1 Concluding Steps	WP Reference
<p>2. Discuss the audit results with the supervisor and, if applicable the technical specialist. The auditor should only report those noncompliances which are considered material. Coordinate significant or unusual issues with the CFAO, FAO Manager, and if applicable, with the 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 less than material, but could become material if circumstances change, notify the contractor and contracting officer in writing, as appropriate (e.g., in a memorandum, via e-mail, or in the report appendix). The written notification will include a Statement of Condition and Recommendation (SOCAR) and provide those charged with governance (the contractor and contracting officer) 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 less than material noncompliance will be reported in a separate appendix to the report titled "Noncompliance that Warrants Attention of those Charged with Governance." Reference to the appendix for the less than material 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>	
<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.</p>	
<p>4. If a material weakness or system deficiency is detected during this audit, ensure that the findings have been fully developed to determine if a material weakness or system deficiency in compliance with DFARS 252.242-7006 Accounting System, DFARS 252.215-7002 Estimating System, or DFARS 252.242-7004 Material Management and Accounting System 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.</p>	
<p>5. Hold an exit conference with the contractor and provide a draft report (and memorandum, if applicable) to the contractor for comments in accordance with CAM 4-304. Obtain supervisory review, and management review if required, of the working papers and draft audit results section of the audit report (and memorandum, if applicable) before discussion with the contractor.</p>	
<p>6. Finalize audit report (and memorandum, if applicable) incorporating the contractor's reaction and audit response, if applicable.</p>	

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A-1 Concluding Steps	WP Reference
7. Complete the administrative working papers.	
8. Complete the following steps: <ul style="list-style-type: none"><li data-bbox="251 361 878 392">• Prepare audit lead workflows, as applicable.</li><li data-bbox="251 394 980 426">• Update the contractor permanent file, as appropriate.</li></ul>	
9. Submit the working paper package and draft report (and memorandum, if applicable) to the supervisor/manager for final review and processing.	