

Master Document – Audit Program

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| Activity Code 10100 | Post Year End Incurred Cost Audit |
| Version 4.0, dated January 2021 | |
| B-1 | Planning Considerations |
| Type of Service - Attestation Examination Engagement | |
| Audit Specific Independence Determination | |
| <p>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.</p> <p><i>(Note: Because staff is sometimes added to on-going audits, supervisors should ensure that all individuals who are directing, performing audit procedures, or reporting on this audit as a member of the audit team or who are performing as a consultant have signed this work 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></p> | |
| Purpose and Scope | |
| <p>This standard audit program assists the auditor in planning and performing the incurred cost audit of a contractor to determine if costs charged to auditable Government contracts are allowable, allocable, and reasonable in accordance with contract terms, applicable generally accepted accounting principles, cost accounting standards, and applicable Government acquisition regulations. This program is intended to be the controlling assignment for the entire incurred cost audit of a contractor fiscal year. It is expected that those portions of the audit which are covered in other work packages will be referenced at the appropriate place in this master assignment, including budgeted and actual hours (applicable to the larger contractor). Audit programs in other work packages (10160) should be cross-referenced back to the control assignment and audit step.</p> <p>It is not expected that the audit steps be completed in the order in which they appear in the audit program. Additionally, these steps are intended as general guidance only, and audit team should expand or eliminate steps as necessary to fit the current audit and best support their assessment of materiality, risk, and milestone planning. The audit program should reflect a mutual understanding amongst the audit team as to the scope required to meet auditing standards and DCAA objectives for the current assignment.</p> <p>If the contractor has CAS-covered contracts, the auditor should test contractor compliance with the applicable CAS requirements as part of their transaction testing steps. The auditor should determine by checking the permanent files and prior audit working papers if significant costs related to CAS have been identified. Contractor compliance with certain CAS 412 and 413 provisions related to defined benefit pension plans must be tested annually, even if there are no pension costs incurred.</p> | |

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| <p>This master program does not provide detailed audit steps for the testing of individual transactions. It is expected that transaction test programs will be developed locally to facilitate an effective audit based on the audit risk at the specific contractor location. Therefore, the program steps should be tailored, as appropriate. For audit areas with multiple sections, the auditor is permitted to remove the sections that are not relevant to the review based on the documented materiality and risk assessment. The audit program should reflect an understanding between the auditors and supervision as to the scope required.</p> | |
| <p>Planning Considerations</p> | |
| <p>Upon receipt, the contractor's incurred cost submission should have been evaluated for adequacy using the "Checklist for Determining Adequacy of Contractor Incurred Cost Proposal" (located in Other Audit Guidance (OAG) under code 10100). The risk-based sampling eligibility determination tool may have been prepared, if applicable. The supervisor may authorize initiation of the preliminary audit steps prior to constructive receipt of all required data. Transaction testing ordinarily should not proceed until all required data have been made available. Follow guidance at CAM 6-706.2, Performance of MAARs Without a Certified Proposal, when starting audit procedures without an adequate proposal. Prior to commencing the audit, review Agency guidance that may impact the audit and adjust audit scope and procedures appropriately.</p> <p>Please Note: Reconciliation steps from C-01 may be approved by the supervisor, as documented in A-01 Initial Supervisory Guidance, for performance concurrent with B-01.</p> | |
| <p>References</p> | |
| | FAR 42.7, DFARS 242.7 |
| | FAR 31.2, DFARS 231.2 |
| | CAM 1-504, Access to Contractor Records |
| | CAM 3-3S1 Special Considerations Audits of Selected Contract Types |
| | CAM 4-400, Audit working Papers |
| | CAM Chapter 6, Incurred Costs Audit Procedures |
| | CAM 10-200 Audit Reports Format and Contents - General |
| | Selected Areas of Cost Guidebook |

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| B-1 | Preliminary Steps | WP Reference |
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| <p>Version 4.0, dated January 2021</p> | |
| <p>ADEQUACY</p> | |
| <p>1. Final Indirect Cost Proposal</p> <ul style="list-style-type: none"> a. Review the "Checklist for Determining Adequacy of Contractor Incurred Cost Proposal" completed during the adequacy review of the incurred cost proposal and note any areas requiring further consideration. b. MAAR 19: Indirect Rate Computations. Verify the mathematical accuracy of the contractor's rate computations. c. Review the completed risk-based sampling eligibility determination tool, if applicable. | |
| <p>COMMUNICATION/COORDINATION WITH OTHERS</p> | |
| <p>2. Identify and contact the contracting officer to notify them of the commencement of audit. Discuss any significant concerns or other information that the contracting officer may have relevant to the audit (e.g., risk related to the contractor's financial condition, statute of limitation dates, significant prior findings, risk-based sampling eligibility determination, contracts that are in overrun position for potential mischarging, etc.) that will impact the audit and adjust the audit scope and procedures accordingly.</p> | |
| <p>3. Identification of any closed contracts. Request the contracting officer or contractor to identify any auditable prime contracts or subcontracts (where the contractor under audit worked as a subcontractor) from Schedule H that has been closed.</p> <ul style="list-style-type: none"> a. If information is received from the contracting officer that prime contract(s) are closed, ensure that the contracts are administratively closed (and the contract amount is finalized without recourse), not just physically complete. b. If information is received from the contractor, take steps to verify the auditable prime contracts or subcontracts identified as closed to contractor supporting documentation (i.e., closing documents). [Note: If a subcontract is closed but the prime contract under which the subcontract was performed is still open, the Government still has recourse to recover costs through the prime contractor. Therefore, discuss/coordinate with the cognizant prime contractor auditor to determine if the prime contract has been closed.] c. Exclude the closed contract dollars from transaction testing, and adjust your audit scope, dollars examined, and total subject matter of audit (materiality) accordingly. | |
| <p>4. Determine if the contractor had any cost reimbursable contract terminations included in its incurred cost proposal.</p> | |

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| <p>a. For negotiated/settled terminations the direct and related indirect costs should be removed from the universe. Verify if the contractor removed the indirect cost (Schedule H) and the related direct costs of the terminated contract from the applicable pool and base used to compute indirect costs for other contracts performed during this fiscal year in accordance with the requirements of FAR 49.303-4(b). If not, adjust/remove the terminated contract costs from the audit scope, dollars examined, and total subject matter of audit (materiality) accordingly.</p> | |
| <p>b. For terminated contract costs that have not been negotiated/settled the auditor needs to coordinate with auditor performing the termination audit to determine whether to remove the direct termination costs and related indirect costs from the audit scope or retain them in the incurred cost audit and provide the audited indirect rates for incorporation into the termination audit results.</p> | |
| <p>5. Where the contractor is performing subcontract or inter-organizational effort (as a lower-tier contractor, coordinate with the prime DCAA office(s) on whether an audit of the subcontractor or inter-organizational transfer cost is needed and if so, coordinate the timing of the audit and expected completion date. If the prime DCAA office does not require an audit, exclude the subcontract / inter-organizational costs from audit and adjust audit scope, dollars examined accordingly. The total subject matter of audit excludes subcontract / inter-organizational costs when an audit is not required.</p> <p><i>[Note: Not applicable for those determined to be closed in step 3 above].</i></p> | |
| <p>6. Coordinate with the Field Detachment (FD) auditor if the proposal includes classified work. Coordinate as early in the audit process as possible to determine together what coordinated audit approach would be most appropriate to address classified contracts. If the cognizant FD office is unknown, email DCAA-FDRST@dcaa.mil. Exclude from dollars examined direct costs of classified contracts related to FD, if applicable. <i>(Note: indirect costs should remain in the dollars examined.)</i></p> | |
| <p>7. Determine if the proposal includes significant corporate or home office cost allocations or shared service cost allocations requiring assist audits. If not clearly identified in the contractor’s proposal, request the contractor to identify its processes for receiving and charging these costs to cost objectives. Based on your understanding of the processes, if required, prepare and request assist audit(s) from DCAA office(s) with corporate/intermediate home office/shared services cost flow downs and/or allocations and establish detailed steps to ensure appropriate audit coverage.</p> | |

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| <p>Exclude the costs which assist audits were requested from audit and adjust the audit scope and dollars examined accordingly. The total subject matter of audit includes corporate/intermediate home office/shared services cost flow downs or allocations regardless of whether an assist audit is requested.</p> | |
| <p>8. Identify any non-DoD contracts subject to audit (Schedule H and K) and obtain approval from the non-DoD customer to bill for our audit services. If approval is not received, adjust the audit scope and dollars examined accordingly. These costs are also removed for the total subject matter of audit for purposes of the materiality calculation.</p> <p><i>Reminder for NASA Contracts – DCAA can no longer self-initiate audits on NASA contracts and subcontracts. Refer to the reimbursable customer billing information in the DMIS user guide (https://infoserv.dcaaintra.mil/reflib/DDCAA/DMIS_User_Guide/Reimbursables/Customer_Info_Sheets/FCID_0100_NASA.pdf).</i></p> | |
| <p>9. Small Business or Non-Traditional Defense Contractors – Inquire with the contractor and identify any contracts that are subject to the Class Deviation – Pilot Program for Streamlining Awards for Innovative Technology Projects. Adjust the audit scope and dollars examined accordingly. These costs are also removed from the total subject matter of audit for purposes of the materiality calculation.</p> <p><i>Contracts, subcontracts and modifications of contracts or subcontracts valued at less than \$7.5 million awarded to a small business concern or nontraditional defense contractor pursuant to a technical, merit-based selection procedure or the Small business Innovation Research Program are exempt from the requirements for audit and records examination under the clause at FAR 52.215-2, Audit and Records-Negotiations. This class deviation is effective for contracts awarded between January 9, 2018 and October 1, 2022 (per Sec. 832, 2021 National Defense Authorization Act (NDAA)). Refer to DPAP memo 2018-00009.</i></p> | |
| MATERIALITY ASSESSMENT | |
| <p>10. Government Participation:</p> <p>a. Review the contractor’s calculation and determine Government flexibly priced contract percentages (Government participation) of the indirect expense base(s) using the schedule of direct costs by contract and cost element from the contractor’s proposal. (Ensure the base amounts reconcile to Schedules A, E and H). Coordinate with Field Detachment, when necessary, to confirm that the classified contracts are coded correctly by contract type. This calculation represents the Government participation during the period of examination and will be used for reporting purposes into the report.</p> | |

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| <p>b. Adjust government participation for materiality and risk assessment purposes taking into consideration contracts already closed, non-DoD contracts and subcontracts for which the civilian agency (reimbursable customer) does not participate in our audit, subcontract cost where the prime / upper-tier auditor does not require an assist audit, T&M contracts, settled cost reimbursable terminations, and contracts subject to the class deviation pilot for innovative technology projects. This calculation assists the audit team in determining the materiality of the indirect portion of the incurred cost for detail testing.</p> | |
| <p>11. Calculate Quantified Materiality: a. Calculate the total subject matter of audit (CAM 6-107.2.b).</p> <p><i>Please note, the total subject matter of audit should be adjusted for those costs that are excluded from the audit subject matter such as closed contracts, settled cost reimbursable terminations, non-DoD contracts where the customer will not fund the audit, and contracts awarded under the Pilot Program for Streamlining Awards for Innovative Technology Projects (DPAP memo 2018-00009).</i></p> | |
| <p>b. Calculate quantified materiality using the materiality formula (CAM 6-107.2.a) and the total subject matter of audit.</p> | |
| <p>12. Identify Significant Cost Elements (Direct and Indirect):</p> | |
| <p>a. Identify each direct and indirect cost element exceeding the quantified materiality threshold.</p> | |
| <p>b. Identify cost elements with values less than the quantified materiality threshold that are significant based on risk factors, qualitative characteristics, variability, and/or stated concerns of the contracting officer.</p> <p>The cost elements identified above will be subject to further audit procedures to support the audit opinion.</p> | |
| <p>13. Calculate Adjusted Materiality in order to identify accounts recorded in Significant Direct Cost Elements (CAM 6-107.1.c):</p> | |
| <p>a. For direct cost elements, start with the quantified materiality threshold and reduce it based on auditor judgement. In most cases, the amount of the reduction is 20 percent of the quantified materiality amount unless an objective case can be made to reduce it further. This is the adjusted materiality amount. <i>Please note, adjusted materiality is calculated separately for each significant cost element.</i></p> <p><i>Note: The contractor’s accounting structure and method of reporting costs should not limit the use of materiality but it may require additional analysis (e.g., data analytics) to properly</i></p> | |

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| <p><i>summarize the cost information prior to the application of adjusted materiality and designing sufficient audit procedures.</i></p> | |
| <p>b. Identify significant accounts/cost amounts proposed in each direct cost element exceeding the adjusted materiality amount.</p> | |
| <p>c. Identify significant accounts/cost amounts based on risk factors, qualitative characteristics, variability, and/or stated concerns of the contracting officer.</p> <p>The accounts/cost amounts identified in b) and c) above will be subject to further audit procedures to support the audit opinion.</p> | |
| <p>14. Calculate Adjusted Materiality for Significant Indirect Cost Elements:</p> <p><i>Note, the contractor’s accounting structure and method of reporting costs should not limit the use of materiality, but may require the audit team to use additional analysis (e.g., data analytics) to summarize the cost information prior to the application of adjusted materiality and designing sufficient audit procedures.</i></p> <p>a. For each significant indirect cost element, divide the quantified materiality amount by the Gov’t participation rate to calculate the <i>revised</i> quantified materiality amount.</p> | |
| <p>b. Reduce the <i>revised</i> quantified materiality (step (a) above) at least 20 percent based on auditor judgement to calculate the adjusted materiality amount.</p> | |
| <p>c. Identify significant accounts/cost amounts proposed in each indirect cost element exceeding the adjusted materiality amount.</p> | |
| <p>d. Identify significant accounts/cost amounts based on risk factors, qualitative characteristics, variability, and/or stated concerns of the contracting officer.</p> <p>The accounts/cost amounts identified in c) and d) above will be subject to further audit procedures to support the audit opinion.</p> <p><i>If the contractor charges the same cost across multiple expense pools (e.g. labor cost, pension cost, etc.), the auditor can combine these costs for testing purposes. The costs must be homogenous and the reasons for separating the cost between expense pools should be verified and tested.</i></p> | |
| <p>COMMUNICATING THE ENGAGEMENT / PLANNING MEETINGS</p> | |

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| <p>15. Hold an initial planning meeting with your supervisor (or if appropriate, the audit team) to discuss the materiality of the audit and discuss the audit scope required to meet auditing standards taking into consideration materiality of the audit assignment. Also include discussion of the milestone plan.</p> | |
| <p>16. 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">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)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)3) 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>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.</p> | |
| <p>17. Hold a planning meeting with the audit team (at a minimum, Supervisor and Auditor) to discuss materiality and the risk assessment. As part of the planning meeting, the audit team should discuss and identify potential noncompliances, whether due to error or fraud that could materially affect the subject matter.</p> <p>The discussion should include:</p> <ul style="list-style-type: none">• relevant prior audit experience (e.g., questioned cost, relevant reported estimating or accounting system deficiencies)• relevant aspects of the contractor and its environment• risk of material noncompliance due to fraud (e.g., the extent of financial incentives, pressures to meet budgetary or 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)) | |

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| <ul style="list-style-type: none"> • other known factors that increase the risk of material noncompliance with laws and regulations • the audit team’s understanding of relevant key internal controls. <p>Document risk factors identified that could materially affect the subject matter and design audit procedures to respond to the increased risk of material noncompliance.</p> <p>Communication among audit team members about the risk of material misstatement due to error or fraud should continue as needed throughout the audit.</p> | |
| CONTRACT BRIEFS AND PERMANENT FILES | |
| 18. Contract Briefs: | |
| <p>a. Determine the reliability of contractor prepared briefs. If reliability of the contractor briefs has not been determined for the fiscal year under audit, test a sample of contractor briefs for significant contracts to original contract document or Electronic Document Access (EDA) for accuracy. Any significant contracts that the contractor has not adequately briefed should be briefed as part of this audit. Review contract briefs for any special/significant contract terms or provisions that impact the reimbursement or allowability of costs incurred and should be considered in the audit scope (e.g., specified unallowable costs, cost limitations, funding ceilings, cost sharing clauses, treatment of pre-contract costs, etc.).</p> <p>Briefing lower-tier subcontracts - The prime upper-tier auditor may need to brief significant lower-tier subcontracts. This should be done prior to final determination for the need for any assist audits / procedures.</p> | |
| <p>b. For contracts ready to close:</p> <p>(1) Determine the period of performance per the contract brief or to the contract and latest modification to ensure it is ready to close. Note contracts that ended during the examination period and plan testing to identify any amounts incurred outside the contract period of performance.</p> | |
| <p>(2) For contracts with a Level of Effort (LOE) clause, plan testing to determine if labor hours by category meet the required LOE per the contract and latest modifications.</p> | |

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| <p>(3) Verify that the total amount proposed does not exceed the lesser of the total allowable costs and fee or funding limitation per the contract brief or contract and latest modification</p> | |
| <p>(4) Determine if any contracts are at or over contract ceiling amounts indicating risk that costs may have been misallocated to other contracts (e.g., losses on one contract are not allowable under another contract).</p> | |
| <p>19. MAAR 3: Permanent Files.</p> <p>Review permanent files, CAS disclosure statement (if applicable)/contractor policies and procedures for the year(s) under audit, multi-segment contractor responsibility matrix (if applicable), and any prior related audits (e.g., business system deficiency reports, CAS audits, DCMA purchasing system review, paid voucher reviews, etc.) to identify potential audit leads, inconsistent treatment of similar costs, or key prior audit findings to be considered in establishing the audit scope.</p> | |
| <p>Obtain current organization charts and compare to charts contained in permanent file to identify any changes in organizational structure requiring follow-up and consideration in the audit scope.</p> | |
| <p>20. Review permanent file to determine if previous audits included findings and recommendations that impact the subject matter under audit. If there were findings, auditors should</p> | |
| <p>document this information in the risk assessment and perform the following procedures:</p> <ul style="list-style-type: none"> a. During the entrance conference, ask contractor management if corrective actions were taken to address findings and recommendations reported in previous DCAA audits (e.g., questioned costs, business system deficiencies, CAS audits) that are relevant to the subject matter of audit. If yes, have contractor explain corrective actions taken and determine if additional audit procedures should be included in the fieldwork to test the corrective actions. (GAGAS 7.13) b. Document the results of the inquiry and the impact of the corrective actions to the subject matter under audit. <p><i>(Note: The purpose of this question is to follow up with contractor on relevant prior DCAA audit findings that could have a material effect on the subject matter of audit.)</i></p> | |
| <p>21. Review permanent file to determine if the contractor has previously provided other studies or audits (e.g., summary listing of internal audits or external audit reports) that directly relate to the subject matter under audit. If there are no other studies or audits, document</p> | |

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| <p>that information in the work papers and perform the procedures below.</p> <ul style="list-style-type: none"> • a. During the entrance conference or another appropriate meeting, 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>b. If the review of the perm file or the contractor identifies relevant internal audits:</p> <ul style="list-style-type: none"> • Determine if access to these reports is necessary to complete the evaluation of the relevant internal controls to support the risk assessment or audit procedures related to the subject matter of the audit. There must be a nexus between the internal audit reports and the scope of this specific assignment. • Document the results of the determination in writing. • If assignment is at a major contractor location, coordinate with the CAC or FAO point of contact (POC) for internal audit reports to request the contractor provide access to the reports. • If assignment is at a non-major contractor and the FAO does not have a designated POC, the auditor should request the contractor provide access to the internal audit reports. • The request, issued by the CAC, FAO POC or auditor, should include information on how the internal audit report is relevant to the DCAA audit. Place a copy of the request in the assignment administrative work papers. | |
| <p>c. If the review of the perm file or the contractor identifies relevant other audits or studies:</p> <ul style="list-style-type: none"> • Obtain publicly available information for the relevant other Government agency audits (e.g., websites for DoD IG or other IGs, service audit agencies, etc.). • Make appropriate adjustments to your risk assessment and planned procedures based on reported findings. • Document the results of the inquiries including the response received from contractor’s for any request for access to internal audit reports. (If access was not granted this should include the contractor’s rationale or justification for not granting access). | |
| <p>d. Review the results and determine if additional audit procedures are needed to address any identified risk. (Note: The purpose of this question is to discover any new audit leads that could affect the scope of current audit.)</p> | |

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| <p>22. MAAR 6 and 13. Document the sufficiency and impact of real-time MAARs on audit scope. If labor and/or material costs are significant, and no real-time testing was performed or real time testing was not sufficient, design alternate procedures to test for existence and allocability, reference MRD 13-PPD-012(R) dated July 18, 2013. [Reminder: the audit team should identify the level of alternate procedures required to examine on the labor or material costs based on identified risk for the cost element, including documenting basis of reliance on computerized data through testing of internal controls for that purpose.]</p> | |
| <p>ANALYTICAL PROCEDURES</p> | |
| <p>23. MAAR 15: Indirect Cost Comparison with Prior Years and Budgets:</p> <p>a. Compare base and pool totals and rates/factors to prior year and budgetary amounts. Determine if the indirect rate structure to accumulate and allocate costs is consistent with the contractor’s written policies/procedures, CAS disclosure statement (if applicable), and indirect rate structure used to prepare forward pricing and/or provisional billing indirect rates for the same year (CAS 401/FAR 31.203).</p> | |
| <p>b. Compare final indirect accounts within pools to prior years and budget to identify changes in accounting practices, reclassification of costs, critical and sensitive accounts, new accounts (including voluntary deleted items), and areas with substantial increases or decreases in costs that require further audit analysis and/or explanation. Analysis should also consider relativity between pools and bases (i.e., consider the indirect expense change relative to the change in base in determining reasonableness).</p> | |
| <p>c. Perform trend analysis to disclose any significant increases in the ratio of direct to indirect labor accounts. Follow-up on significant fluctuations requiring further audit analysis and/or explanation (e.g., the contractor may be misclassifying direct contract costs to selling and marketing costs or IR&D/B&P costs).</p> | |
| <p>d. Obtain supporting account detail entries for accounts determined to be sensitive, new accounts with significant costs, and accounts with large variances from performing steps b. and c. above. If material, tailor the detailed audit steps to address any risks identified.</p> | |

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| <p>24. MAAR 8: Comparative Analysis –Sensitive Labor Accounts. Perform a comparative analysis of sensitive labor accounts (e.g., standby labor or indirect charging by direct labor employees) to identify any sensitive labor changes that vary significantly from prior periods and/or budgetary estimates. Be alert to situations where labor is being excluded from overhead allocation bases or transferred from the allocation base to the indirect cost pool.</p> | |
| <p>25. MAAR 7: Changes in Charging Direct/Indirect costs. Based on the performance of the preliminary audit steps and other known information, evaluate any identified significant changes in practices for charging direct/indirect costs for consistency with generally accepted accounting principles, the applicable costs principles per contracts, and any applicable CAS requirements. The purpose is to verify that changes in charging do not have the effect of improperly shifting costs among cost objectives, circumventing cost targets or ceilings of certain contracts, or other significant costs categories.</p> | |
| <p>26. Review contractor’s executive compensation schedule (Supplement Sch. B) Compensation for Certain Contractor Employees per FAR 31.205-6(p). Analyze significant changes from prior years. Review for compliance with regulatory compensation caps. Assess the level of risk for unreasonable compensation and whether testing should be performed to evaluate compliance with FAR 31.205-6. Coordinate with the Agency Compensation Team, if necessary.</p> | |
| <p>27. Perform a profit margin test on T&M/Labor Hour contracts by comparing total contract billed amounts (e.g., from Schedule K of the contractor’s submission) to total actual contract costs reported (e.g., from Schedule H). Follow-up on any contracts that appear to have significant profit margin. If variances in labor rates are the cause for the significant profit margin, assess the risk that the contractor is substituting less qualified employees and adjust audit scope for labor billings/costs accordingly.</p> | |
| <p>28. Schedule I Billing Variances: Scan Schedule I for material over / under billings at both the total and individual contract level. If material variances are identified:</p> <ul style="list-style-type: none"> • Determine the cause (timing issues, over/understated billing rates, etc.); • Adjust the cost element risk and scope of testing, if necessary; • Discuss with the supervisor the need to set up an audit to examine the contractor’s compliance with DFARS 252.242-7006(c)(15)(i) and (16). | |

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| <p><i>Note: Variances between provisional and actual rates should cause variances on all contracts to go same direction (positive or negative). If there are both significant over and under billings, this is an indicator that another factor may be contributing to the variances.</i></p> | |
| <p>INTERNAL CONTROLS <i>[Note – this section is applicable to the controls, processes, and procedures in place for the year in which the costs were incurred.]</i></p> | |
| <p>29. Obtain and document an understanding of the contractor’s incurred cost proposal and its processes for developing the proposal using the framework of WP B-2. Obtain and document an understanding of the underlying related supporting documentation and the relevant policies/procedures /processes related to those specific incurred cost areas (e.g., the basis of the costs and from where the numbers/amounts are derived) that we selected for detailed testing based on materiality.</p> | |
| <p>a. Coordinate with contractor and obtain a walk-through of the incurred cost proposal. If necessary, obtain subsequent walkthroughs of specific processes. If applicable, the walk-through should be coordinated to include the FD audit team.</p> | |
| <p>b. Review other sources in which an understanding can be established such as concurrent audits that were performed (MAAR 6 and MAAR 13), accounting system audit, DCMA CPSR review, etc.</p> | |
| <p>c. This understanding should include the following as applicable:</p> <ul style="list-style-type: none"> • The contractor’s subcontract award and management process and the extent of the contractor’s evaluation of subcontract costs to ensure compliance with contract terms. • An understanding of the contractor’s inter-organizational transfer (IOT) policies and procedures. Make inquiries relating to inter-organizational transfers and/or related party transactions. Gain understanding of where costs are proposed (i.e. are costs included in both authorizing and performing segments’ incurred cost proposal (ICP)?) Determine if profit is treated properly (FAR 31.205-26(e)). • The contractor’s management system regarding adherence to budgetary controls and if managers’ bonuses or incentives are determined based on performance against some predetermined budget (Tight budgetary policies may increase the risk of labor mischarging). | |

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| <ul style="list-style-type: none"> • Gain an understanding of the contractor’s process in setting the compensation package (executive and nonexecutive) and ensuring that the aggregate of each element of the total compensation package complies with the allowability and reasonableness requirements of FAR 31.205-6. If the Agency Compensation Team will perform detailed procedures, the FAO and Compensation Team auditors should coordinate with the contractor and obtain a detailed walkthrough of the compensation system. Based on this understanding of the system and identified risks, tailor detailed procedures to test for compliance with FAR 31.205-6. • An understanding of the accumulation of classified contract costs in the contractor’s business systems. Specifically, note if there are any departures from standard policies and procedures or separate accounting, billing, labor, material, subcontract management, etc. systems for classified contract costs and how the data from these systems is incorporated into the ICP. • Establish additional procedures based on risk disclosed. | |
| <p>30. Document assessment of control risk.</p> | |
| <p>31. Document the reliance that can be placed on computerized data relevant to the period under audit.</p> | |
| <p>32. Scanning Controls. Determine the reliance of scanned documents for the contractor’s fiscal year being audited. If not performed in another assignment, request the contractor to provide a demonstration/walkthrough to obtain an understanding of the system and control activities over the functional elements that make up the source document imaging process. If necessary, include audit procedures to test a sample of images to original documentation as part of audit scope.</p> | |
| <p>33. Testing to Payment for Non-Labor Costs. Obtain an understanding of the contractor’s policies, procedures, and processes, including internal controls, applicable to the fiscal year under audit for ensuring timely payment of costs. Consider the contractor’s financial statements and aging of accounts payable, financial condition, or other considerations that identify risk the contractor is delinquent in paying costs in the ordinary course of business. Assess the risk of the contractor being materially non-compliant (i.e., delinquent in payment of cost).</p> | |
| <p>a. Consider the results of testing to payments performed during the incurred cost fiscal year in other assignments (e.g., paid voucher, accounting/billing system). Document the reliance on any specific audit work previously performed.</p> | |

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| <p>b. Based on your materiality and risk assessment, design audit procedures to ensure the contractor’s compliance with FAR 52.216-7(b)(1).</p> <p>(1) If the risk of non-payment is low, perform a judgmental selection or statistical sample of all payments (i.e., all non-labor expense accounts) to source documents (e.g., cancelled checks, electronic funds transfers, bank statements, or other evidence of payment).</p> <p>(2) If the risk of non-payment is high, establish payment as a criterion when testing for allowability.</p> | |
| <p>OTHER PROCEDURES THAT MAY NEED TO BE PERFORMED BASED ON DOLLARS EXAMINED, GOVERNMENT PARTICIPATION, PRIOR AUDIT FINDINGS, OR SIGNIFICANCE <i>(For the majority of non-major contractors, these steps may not be applicable. Discuss with your supervisor and obtain approval prior to performing these steps.)</i></p> | |
| <p>34. Excessive Pass Through Costs (FAR 52.215-23- previously DFARS 252.215-7004). (The DFARS clause became effective for all contracts awarded after 4/26/2007. The FAR clause became effective 10/14/2009.) If costs for total subcontract effort are expected to exceed 70 percent of the total costs of work to be performed (at total contract level), the prime / upper-tier contractor must provide evidence of its “added value”.</p> <p>For DoD, all flexibly priced contracts awarded on or after 4/26/2007 are subject to pass-through limitations, except FPI contracts awarded competitively or for commercial items. For civilian agencies, all cost reimbursement type contracts awarded on or after 10/14/2009 over the simplified acquisition threshold are subject to the limitation.</p> <p>a. Analyze the incurred cost proposal (Schedules J and H) for indicators of contracts at risk for excessive pass-through costs.</p> | |
| <p>b. Since the ICP is snapshot in time and changes often occur, it may be necessary (based on risk) to request the contractor to identify contracts in which the current total subcontract value is expected to exceed 70% of total contract costs.</p> | |
| <p>c. Based on the above, design the procedures in section F to ensure the submission does not include unallowable excessive pass-through charges in accordance with FAR 31.203(i).</p> | |
| <p>35. Review applicable Board of Directors’ minutes and audit committee minutes for the year(s) being audited (or corporate auditor’s review) for potential audit leads requiring follow-up and consideration in audit scope (CAM 3-204.17(c)).</p> | |

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| <p>36. MAAR 4: Tax Returns and Financial Statements. If the contractor is a corporation that prepares consolidated financial statements, these steps are usually largely performed by the corporate auditors. Auditors of contractor segments should coordinate with the corporate auditors to (1) pursue audit leads identified by the corporate auditors and (2) assess additional audit effort necessary at the segment level. All auditors should review the notes to the financial statements for possible audit leads requiring follow-up (CAM 3-204.17c).</p> | |
| <p>a. Review corporate financial statements, tax returns and SEC filings as appropriate. Follow-up on any significant audit issues (e.g., credits, organizational changes, litigation issues, related party transactions, etc.).</p> | |
| <p>b. Review Federal Income Tax Returns for compliance with FAR 31.205-41 to identify duplicate recovery of foreign income tax expenditures---first as a contract cost and second as a reduction to its federal income tax liability (Selected Areas of Cost Guidebook; Chapter 68-7).</p> | |
| <p>c. Review a copy of external auditor's internal control letter or statement that the external auditor did not prepare an internal control letter. For publicly traded companies that file financial information with the SEC, review the “internal control report” prepared by management that accompanies the financial statements for any audit leads.</p> | |
| <p>37. For contractors with defined benefit pension plans, review the Report on Contractor Pension and Post Retirement Benefit (PRB) Plans and other information required in DCAA Instruction 7600.3, Contractor Pension and PRB Reporting, to identify significant events that may require a review of Contractor Insurance and Pension Review (CIPR) based on the risk assessment. DCMA is the DoD Executive Agency for the performance of all CIPRs. The ACO determines the need for a CIPR or special CIPR. As an advisor to the ACO, the auditor should notify the ACO if there are indicators that may determine the need for a CIPR or special CIPR based on the risk assessment.</p> | |
| <p>38. Review the contractor’s listing of facilities. Identify any facilities that do not contain any (or only a few) employees. In addition, identify any facilities that are owned by a related company.</p> | |

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| <p>39. Determine the significance of (unclassified) Independent Research and Development (IR&D) cost incurred on or after January 30, 2012 that the contractor proposes to allocate to unsettled flexibly-priced contracts awarded on or after January 30, 2012. These costs may be subject to the DFARS 231.205-18(c)(iii)(C) requirement that certain contractors report IR&D information to the Defense Technical Information Center (DTIC) in order to claim the costs as allowable.</p> <p>If significant, determine if the contractor is a “major” contractor as defined in DFARS 231.205-18(a) that is required to comply with the allowability provisions at DFARS 231.205-18(c), and assess the risk of material noncompliance, by accomplishing the following:</p> | |
| <p>a. During the walk-through, request the contractor to provide rationale for a classification other than “major” as defined in DFARS 231.205-18(a). If the contractor is a segment under a home office, coordinate with auditors at the home office to ensure consistency.</p> | |
| <p>b. For contractors meeting the definition of “major,” obtain:</p> <ul style="list-style-type: none"> (1) policies and procedures to report IR&D projects to the DTIC database as required by DFARS 231.205-18(c)(iii)(C), and (2) access to contractor’s input provided to the DTIC database pertaining to IR&D project costs included in the contractor’s incurred cost proposal. | |
| <p>c. Based on the information obtained, for “major” contractors as defined in DFARS 231.205-18(a) with significant IR&D, assess whether to include audit steps in Section H to test that IR&D meets the allowability criteria in DFARS 231.20518(c). If the auditor selects IR&D for testing, review the Selected Areas of Cost Guidebook, Chapter 33.</p> | |
| <p>SUMMARY OF MATERIALITY AND RISK ASSESSMENT AND SCOPE OF AUDIT</p> | |

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| <p>40. Conduct an entrance conference. Confirm the team’s understanding of the contractor’s incurred cost proposal and supporting data. If the contractor under audit performs as a subcontractor, obtain the written consent for release of the audit report to the prime / upper-tier contractor, or reason(s) for not authorizing release. Discuss the availability of required data and personnel necessary to timely support the audit. If applicable, include a follow up with contractor management on:</p> <ol style="list-style-type: none"> a. corrective actions that address previous DCAA audit findings and recommendations, b. other studies or audits that impact the subject matter under audit. | |
| <p>41. MAAR 12. Assess the need for an assist audit on significant lower-tier subcontract and inter-organizational transfer (IOT) costs included in the prime/higher tier contractor’s (contractor under audit) ICP based on documented risk. This assessment should include coordination with the auditors cognizant of the lower-tier contractor / performing segment and should take place prior to sending a request for assist audit:</p> | |
| <ul style="list-style-type: none"> • The need for assist audits of subcontract and IOT costs under flexibly priced prime contracts should be assessed on an annual basis for the specific year currently under audit. • Depending on the circumstances, the prime / upper-tier auditor may need to brief significant subcontracts before determining needed assist audits / services. • If the lower tier contractor has not submitted or is not required to submit an ICP, discuss alternate procedures / audit services that will satisfy the assessed risk with the lower-tier auditor. • Requested assist audits should be acknowledged generally within 5 business days (CAM 4-104). Follow-up with the lower-tier auditor if not received within reasonable timeframe. • Due care should be taken to ensure both the prime / upper-tier and lower tier subcontract audits are completed within the required timeframe (i.e. one year) for any adequate submission received December 12, 2017 or later. • The prime / upper-tier and lower tier auditors should communicate known risks from their perspective early to design the nature, extent, and timing of appropriate audit procedures. | |

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| <p>42. Review and discuss with your supervisor (or if appropriate, the audit team) the overall results of the materiality and risk assessment and the audit scope planned in response, including the detailed audit steps. Make any further adjustments to the audit program steps necessary to obtain sufficient evidence to provide a reasonable basis for the conclusion that will be expressed in the audit report. Finalize the milestone plan.</p> <p>Obtain and document supervisory approval of the materiality and risk assessment, the planned scope of examination for each audit area documented in WP B and -1 WPs, and the milestone plan.</p> | |
| <p>43. Calculate final dollars examined (i.e., removing: contracts that are closed, nonDoD contracts/subcontracts where agency is not participating, lower-tier subcontract dollars related to assist audits requested in this audit, dollars associated with subcontracts / IOTs that prime / upper-tier auditor does not require an audit, corporate/IHO/shared services flow downs and/or allocations that corporate/IHO/shared services auditors already included in their audits, classified contracts (where applicable), terminated contracts, etc.)</p> <p><i>[Note: Refer to DMIS User Guide for detailed procedures for calculating dollars examined.]</i></p> | |
| <p>44. Electronically transmit an acknowledgement/notification letter to the appropriate Contracting Officer and the Contractor to formally notify them of the audit and expected completion date in accordance with CAM 4-104. The acknowledgement/notification letter should be issued within the timeframe and in accordance with the procedures in CAM 4-104 and CAM 4-302.3.</p> <p><i>Note - For adequate submissions received on or after December 12, 2017, the audit should be completed within 1 year of receipt.</i></p> | |

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| C-1 | Reconciliations | WP Reference |
| Version 4.0, dated January 2021 | | |

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| <p>1. MAAR 2: Contract Cost Analysis and Reconciliation to Books. Verify the contractor’s reconciliation of costs by major cost element under auditable Government contracts to the contractor’s job cost subsidiary ledger and other accounting system records. Reconcile significant direct cost elements to job cost ledger on significant contracts. Coordinate with Field Detachment, as needed, to address classified contracts. Follow-up and obtain explanations on significant differences.</p> | |
| <p>2. MAAR 14: Pools/Bases Reconciliation to books. Verify the pools and allocation bases to accounting records to determine that the amounts reconcile to the contractor’s general ledger. Reconcile significant indirect cost accounts and significant base amounts to the general ledger. Follow-up on significant differences. Coordinate with Field Detachment, as applicable, to ensure all classified contracts are included in the base.</p> | |
| <p>3. MAAR 9: Payroll/Labor Distribution Reconciliation. a. Reconcile Schedule L total payroll dollars with totals of related labor cost in the general ledger and labor distribution records.</p> | |
| <p>b. Reconcile Schedule L total payroll dollars and payroll taxes to the IRS Form 941. (Reconciliation of total payroll dollars to payroll taxes to the IRS Form 941 may assist in validating there were no fictitious employees).</p> | |
| <p>c. If the Cognizant Federal Agency Official (CFAO) granted the contractor a waiver for submitting Schedule L as part of its annual indirect cost rate proposal, obtain a copy of the waiver. Confirm an alternate Schedule L was submitted and document the working papers. Ensure the alternate schedule reconciles labor costs in the submission to the general ledger, labor distribution and payroll records.</p> | |
| <p>d. If segments report to a Home Office/Division, the MAAR 9 should be performed by the DCAA office with audit cognizance at Home office or Divisional level and that office should provide results to the impacted segments. Follow up with contractor on significant differences.</p> | |
| <p>4. Inter-Organizational Transfers (IOTs). Selectively reconcile the prime / upper-tier contractor's schedule of IOTs under flexibly priced prime Government contracts / upper-tier IOTS to the lower-tier contractor’s books and records (assistance from the lower-tier auditor may be needed). If not already provided, obtain a listing of the IOTs showing the incurred costs by performing division.</p> | |

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| <p>5. Reconcile voluntary deleted items identified in the incurred cost proposal to the books and records and ensure all voluntary deleted account balances are identified and accounted for as unreimbursable, including directly associated unallowable costs in accordance with FAR 31.201-6. Identify potential directly associated unallowable costs that may not have been removed from the proposal for consideration in planning transaction testing.</p> | |
| <p>6. Summarize the results and note whether any areas require further analysis during transaction testing.</p> | |

| D-1 | Direct and Indirect Labor | WP Reference |
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| Version 4.0, dated January 2021 | | |
| | <p>1. MAAR 6: Contractor Labor Audit (CAM 6-404). If applicable, review and incorporate the results of the MAAR 6 (labor floor check and interview) audit. Based on the results of the preliminary steps that identified materiality and risk, perform additional labor testing procedures, as required, to evaluate the allowability, allocability, and reasonableness of incurred labor costs. <i>Coordinate with Field Detachment as necessary to address direct labor costs on classified contracts.</i> Determine if testing to payment is necessary.</p> | |
| | <p>2. MAAR 8. Comparative Analysis-Sensitive Labor Accounts. Evaluate any significant changes resulting from comparative analysis of sensitive labor accounts for possible misclassification.</p> | |
| | <p>3. MAAR 9: Payroll/Labor Distribution Testing (CAM 6-406). Test quarterly taxes to evidence of payment (e.g., contractor bank statements, electronic funds transfer, or third party payroll processor records). Verify total taxes owed were paid.</p> | |
| | <p>4. MAAR 10: Adjusting Entries and Exception Reports (CAM 6-404.6b (6)). Evaluate adjusting journal entries and exception reports for direct and indirect labor. Identify adjustments (e.g., unusual labor transfers) requiring further examination and explanation. Based on risk, test direct and indirect labor adjusting entries. Be alert to situations where labor costs are being transferred without supporting timecards and/or documentation. Obtain and analyze explanations for any abnormal adjusting entries or corrections.</p> | |

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| <p>5. For T&M or Labor Hour contracts, based on the preliminary steps that identified materiality and risk, select a sample of contracts for testing of details:</p> <p>a. Determine if the proposed incurred and billed hours reconcile to the contractor’s books and record (e.g., timesheets, labor distributions reports, and job cost summary reports).</p> | |
| <p>b. Review and determine whether labor hours and rates comply with contract provisions.</p> | |
| <p>c. Based on the results of the materiality and risk assessment, test employee qualifications (education and experience) comply with contract provisions (FAR 52.232-7(a)(3)).</p> | |
| <p>6. Executive Compensation:</p> <p>a. Trace the executive compensation costs to the appropriate G&A and overhead accounts to ensure that all the executive compensation is being evaluated for reasonableness.</p> | |
| <p>b. Perform sufficient steps to verify that all allocable direct and indirect executive compensation in excess of the statutory compensation ceilings (See CAM 6-414) has either been appropriately: (i) excluded from the contractor’s incurred cost submission, or (ii) identified as expressly unallowable costs and questioned in the audit report.</p> | |
| <p>7. Reasonableness of Non-Executive Compensation (including bonuses and awards): If indicated by the materiality and risk assessment, test the reasonableness of non- executive compensation. Review the contractor’s evaluation of external equity for compliance with policies, procedures and FAR 31.205-6. Consider coordinating with the Agency Compensation Team for guidance and assistance. See CAM 6-413.</p> | |
| <p>8. Verify that any questioned labor related costs also considers directly associated costs that should also be excluded/questioned (FAR 31.2016(a)).</p> | |
| <p>9. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.</p> <p><i>[Note: If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.]</i></p> | |

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| E-1 | Direct Material | WP Reference |
| Version 4.0, dated January 2021 | | |

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| <p>1. MAAR 10: Adjusting Entries and Exception Reports (CAM 6-305.3a (1)). Request the contractor to provide adjusting journal entries and exception reports for direct materials. Evaluate and identify adjustments requiring further analysis and explanation (e.g., transfers between direct/indirect, FFP to Cost Type contracts, or unallowable/unbillable amounts to allowable amounts).</p> | |
| <p>2. MAAR 13: Purchases Existence and Consumption (CAM 6-305.3a(2)). If applicable, review and incorporate the results of MAAR 13. Based on the results of the preliminary steps that identified materiality and the risk, perform additional material testing procedures, as required, to examine on the incurred material cost. <i>Coordinate with Field Detachment as necessary to address material costs on classified contracts.</i> During testing, determine materials purchased were required for the contract, purchased in reasonable quantity and at a reasonable price, used on the contract, in compliance with contract terms and CAS if applicable (i.e., CAS 402 and 411), and were properly accounted for. Determine if testing to payment is necessary.</p> | |
| <p>3. Verify that any questioned direct material costs also considers directly associated costs that should also be excluded/questioned (FAR 31.2016(a)).</p> | |
| <p>4. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.</p> <p><i>[Note: If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.]</i></p> | |

| F-1 | Subcontracts | WP Reference |
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| Version 4.0, dated January 2021 | | |
| <p><i>This section is applicable to all lower-tier subcontract costs included in the prime / upper-tier contractor’s ICP including those in which assist audits (MAAR12) were requested and fixed priced subcontracts under flexibly priced prime contracts.</i></p> | | |
| <p>1. MAAR 10: Adjusting Entries and Exception Reports.</p> <ul style="list-style-type: none"> • Evaluate adjusting journal entries and exception reports for subcontract costs. • Identify adjustments requiring further analysis and explanation. | | |

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| <p>2. Based on the results of the preliminary steps that identified materiality and the risk, perform the following to assess allowability (FAR 31.201-2) for selected subcontracts (including fixed priced subcontracts and those flexibly priced subcontracts that assist audits were requested for) issued under flexibly priced prime contracts / upper-tier subcontracts. Coordinate with Field Detachment as necessary to address subcontract costs on classified contracts.</p> | |
| <p>a. Determine if the subcontract costs are allocable (FAR 31.201-4) to the prime contract (i.e. was effort consistent with (sub)contract requirements, is the subcontract SOW consistent with prime contract, etc.?)</p> | |
| <p>b. Verify the existence, accuracy and proper recording of the subcontract cost included in the prime/upper tier contractor’s ICP. Perform the following as applicable and risk dictates:</p> <ul style="list-style-type: none"> • Trace the prime / upper tier contractor’s proposed subcontract cost to billings submitted by the lower tier contractor. | |
| <ul style="list-style-type: none"> • Ensure prices and units on the invoices (i.e., billings) match prices and units specified in the subcontract or purchase order. | |
| <ul style="list-style-type: none"> • Verify goods were received and services were performed. | |
| <p>c. If the risk of non-payment was assessed as high (B-01 Step 31), perform testing of payments to ensure subcontract costs were paid.</p> | |
| <p>d. Determine if subcontract costs are reasonable (FAR 31.201-3) at prime contract level.</p> <ul style="list-style-type: none"> • <i>(Note: For some subcontracts, this could have been previously tested in prior incurred costs audits, during the price proposal audit, or post payment testing of paid vouchers. (Reliance should be placed on prior audits to the maximum extent possible)</i> • This may involve reviewing the purchasing file for evidence of reasonableness. This may include the basis for subcontract selection, cost/price analysis, adequate competition, make/buy decision, verifying materials/services were needed, etc.). • If the contractor has little or no evidence to support reasonableness, consider alternate procedures that can be performed to test for reasonableness. <i>(Note: Costs should not be questioned if reasonableness cannot be established. If significant, a reservation on the engagement should be reported as well as the non-compliance with FAR 31.201-2(d).</i> • If the costs are deemed unreasonable, design procedures to develop an audit position on the unreasonable portion and question accordingly. | |

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| <p>e. Ensure the lower-tier subcontractor billings submitted to the prime / upper-tier contractor are in compliance with contractual terms (requires briefing both the prime / upper-tier contract and subcontract). Including the following:</p> <ul style="list-style-type: none"> • Compliance with any special provisions, limitations, etc. This includes ensuring subcontract terms and costs do not violate prime contract terms. • Cost type subcontracts – Verify billings indicate that subcontracts costs are billed at cost incurred plus fee (if applicable), and within contract ceiling amounts. Also, verify provisional billing rates are updated to reflect final year-end rates. • T&M/LH subcontracts – Ensure subcontract labor rates and hours billed to the prime are consistent with the terms of the subcontract and in compliance with applicable versions of the FAR 52.232-7 payment clause. <p><i>Note: For subcontracts in which assist audits were requested, ensure proper coordination with lower-tier auditor to avoid any duplication of effort.</i></p> | |
| <p>3. MAAR 12. If assist audits were received, address any significant questioned costs in the assist audit report that pertain to your contracts with the prime or upper-tier contractor. Obtain the prime or upper-tier contractor’s position on the questioned costs. Incorporate the questioned costs after considering prime / upper-tier contractor’s position. Follow-up on requested assist audits that have not been received.</p> | |
| <p>OTHER PROCEDURES THAT MAY NEED TO BE PERFORMED <i>(For the majority of non-major contractors, these steps may not be applicable. Discuss with your supervisor and obtain approval prior to performing these steps.)</i></p> | |
| <p>4. Excessive Pass through Charges (FAR 52.215-23, previously DFARS 252.215-7004, the DFARS clause became effective for all contracts awarded after 4/26/2007 and the FAR clause became effective 10/14/2009). Contractors are required to identify the percentage of work that will be subcontracted. When the percentage of total subcontract effort is greater than 70 percent of the total work to be performed (at total contract level), the contractor must provide information supporting the value it adds with regard to the subcontracted work. Using the information obtained in B, ensure the submission does not include unallowable excessive pass-through charges in accordance with FAR 52.215-22 and FAR 52.215-23.</p> | |

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| <p>a. If the contract contains FAR 52.215-23 Alternate I, the contracting officer made a determination at the time of award that the prospective contractor has demonstrated that its functions provide added value to the contracting effort and there are no excessive pass-through charges. Auditors should</p> <p>(1) Compare the contractor demonstrated value added functions with those disclosed to the contracting officer at the time of award to ensure the functions billed or incurred are consistent with the contracting officers determination;</p> <p>(2) Ensure the disclosed value-added functions were performed and are reasonable.</p> | |
| <p>b. If the contract does not contain FAR Alternate I, the auditor perform procedures to determine if the contractor incurred excessive pass through charges as defined in FAR 52.21523.</p> | |
| <p>(1) Request the contractor to identify the value added functions it provided consistent with the definition in the contract clause.</p> | |
| <p>(2) Verify the disclosed functions were performed, are reasonable and represent value added effort.</p> | |
| <p>(3) FAR 52.215-23(c) requires the contractor to notify the Contracting Officer if there are changes in subcontract effort after award that results in it exceeding 70% of total contract value. The auditor should request the contractor to provide evidence of written notification to the contracting officer that more than 70 percent of the total costs of the work to be performed by subcontractors. If the contractor did not comply with this requirement, the auditor should notify the CO and consider if a DFARS system deficiency exists.</p> | |
| <p>c. If the functions were not performed or add no or negligible value to the contract, then the indirect costs added by the prime contractor to the subcontracted work should be questioned as excessive pass through charges in accordance with FAR 31.203(i).</p> | |
| <p>SUMMARIZE RESULTS</p> | |
| <p>5. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.</p> <p><i>[Note: Questioned cost for subcontract effort that is not concurred should be resolved at the prime level (prime contractor and prime’s CFAO) using DCAA Form 1 procedures (CAM 6-900).]</i></p> | |

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| G-1 | Other Direct Costs (ODC) | WP Reference |
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| Version 4.0, dated January 2021 | | |
| 1. | MAAR 10: Adjusting Entries and Exception Reports. Evaluate adjusting journal entries and exception reports for other direct costs. Identify adjustments requiring further analysis and explanation. | |
| 2. | Based on the results of the preliminary steps that identified materiality and risk, perform adequate testing of significant ODC transactions for allowability, allocability, and reasonableness. Coordinate with Field Detachment as necessary to address ODCs on classified contracts. Determine if testing to payment is necessary. For selected transactions, evaluate source documents for completeness and accuracy, and determine the appropriateness of the charge with respect to term of the contract and FAR/CAS. For example, ensure that the contractor is treating costs of like items in the same manner (FAR 31.202, FAR 31.203, and/or CAS 402). | |
| 3. | Verify that any questioned other direct cost also considers directly associated costs that should also be excluded/questioned (FAR 31.2016(a)). | |
| 4. | Summarize the results including the conclusions, basis of proposed cost, and audit evaluation. <i>[Note: If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.]</i> | |

| H-1 | Indirect Expenses and Cost of Money | WP Reference |
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| Version 4.0, dated January 2021 | | |
| PROCEDURES FOR ALL CONTRACTORS | | |
| 1. | MAAR 5: General Ledger, Trial Balance, Income and/or Credit Adjustments (CAM 6-608.2d (5)). Document your understanding of the types of income and credits occurring at this contractor, and your understanding of the contractors methods for accounting for income and credits. Analyze the contractor’s general ledger, trial balance and entries to profit accounts and other income accounts to identify any credits or income that have not been accounted for which the government may be entitled to a credit. Examples include purchase discounts, scrap sales, rental income, excessive company reserves, insurance and state tax rebates and refunds, etc. Identify adjustments requiring follow-up. | |

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| <p>2. MAAR 10: Adjusting Entries and Exception Reports. Evaluate adjusting journal entries and exception reports for indirect expenses. Identify significant and/or sensitive adjustments requiring further analysis and explanation (e.g., journal entries reclassifying direct to indirect costs).</p> | |
| <p>3. MAAR 16: Indirect Account Analysis (CAM 6-608.2c). Based on the results of the preliminary steps that identified materiality and risk, perform transaction testing on accounts to obtain sufficient evidence for allowability, allocability, and reasonableness of these costs. Determine if testing to payment is necessary.</p> | |
| <p>4. MAAR 18: Indirect Allocation Bases. Evaluate the contractor's indirect cost allocation base(s) for equity and consistency and generally accepted accounting principles, FAR 31.203(c) and CAS 410 and 418, if applicable. Verify that the base(s) properly: (i) reflect(s) the appropriate cost accounting period; and (ii) allocates indirect cost to final cost objectives commensurate with the benefits received (CAM 6-606 and 6-610.2).</p> | |
| <p>5. Determine if the same accounting period is used for accumulating costs in an indirect costs pool as for establishing its allocation base CAS 406/FAR 31.203(g).</p> | |
| <p>6. If any terminated cost-reimbursement type contracts containing the allowable cost and payment clause (FAR 52.216-7) were settled by the Termination Contracting Officer (TCO) using non-final indirect rates, verify that the contractor removed all negotiated indirect costs and related direct costs from applicable pools and bases before preparing its incurred cost proposal (FAR 49.303(b)). If the contractor has not removed negotiated indirect costs and related direct costs for this circumstance, exclude the costs from applicable pools and bases.</p> | |
| <p>7. Cost of Money. If the submission includes cost of money rates, verify the amounts on the CASB-CMF form, Facilities Capital Cost of Money Factors Computation, to source documents and verify the accuracy of the contractor's calculations.</p> <p>a. Verify compliance with the provisions of CAS 414 and FAR 31.205-10.</p> | |
| <p>b. Ensure the contractor use the same base used to allocate the other expenses included in the cost pool.</p> | |
| <p>c. Ensure the contractor used applicable cost of money rate for that FY (CAM 8-414.2).</p> | |

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| <p>8. Indirect Cost Limitation for Basic Research Awards: Review the contractor briefs to ascertain the contractor’s “basic research” awards and the applicable FY appropriated funds paid. If the contractor has Basic Research Awards, see CAM 6-612.</p> | |
| <p>9. If requested assist audit(s) for significant corporate or home office allocations, or shared service cost allocations were received, compare the allowable costs in the assist audit report(s) to the amounts in the prime / upper-tier segments ICP. Determine the impact, if any, on the final rates. Follow-up on requested assist audits that have not been received.</p> | |
| <p>10. Verify that any questioned indirect costs also consider directly associated costs that should be questioned (FAR 31.201-6(a)).</p> | |
| <p>OTHER PROCEDURES THAT MAY NEED TO BE PERFORMED <i>(For the majority of non-major contractors, these steps may not be applicable. Discuss with your supervisor and obtain approval prior to performing these steps.)</i></p> | |
| <p>11. Pension Costs. Evaluate Pension costs for significance (i.e. materiality and/or risk). Pension costs are audited by the FAO cognizant of the contractor location where the plans are administered and the costs are incurred. For multi-segment contractors, this will generally be the corporate home office. Therefore, divisional auditors may need to request an assist audit from the FAO cognizant of the corporate home office.</p> | |
| <p>a. If the costs are auditable at your location and significant, (i.e. material and/or risk factors have been identified) develop an audit program considering the FAR and CAS requirements (e.g., relevant audit steps may be considered from the CAS compliance audit programs). Identify any terminated pension plan costs or credits on the books for this contractor or for acquired or absorbed divisions or other division employees for further review.</p> | |
| <p>b. If the costs are significant (i.e. material and or risk factors have been identified), test contractor contributions under employee pension plans to evidence of payment (i.e., contractor bank statements, electronic funds transfer, or third party payroll processor records).</p> | |
| <p>12. If no pension costs are incurred for the year, the following steps are mandatory for defined benefit pension plans:</p> | |
| <p>a. Evaluate the Trustee report and obtain an explanation for any significant withdrawals of pension assets. Perform additional audit steps as needed to ensure that Government contributed pension assets are protected.</p> | |

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| <p>b. If the contractor’s practice is to calculate pension costs by segment:</p> | |
| <p>(1) Verify that the records required by CAS 413.50(c)(7) are properly maintained and that investment earnings of the trust are allocated in accordance with CAS 413.50(c)(7).</p> | |
| <p>(2) Determine if the transfer of active employees among segments distorts the ratio of assets to the actuarial accrued liabilities.</p> | |
| <p>(3) If so, verify that assets equal to the employees’ actuarial accrued liabilities (determined using the accrued benefit cost method) were transferred in accordance with CAS 413.50(c)(8). Consider requesting the assistance of the DCMA pension specialist through the ACO.</p> | |
| <p>13. Health Care Costs. As part of the review of health care costs, verify the contractor included only health insurance premiums and claims for “eligible dependents”. Request the contractor to demonstrate its procedures for ensuring only costs related to eligible dependents have been included in the proposed allowable costs. Based on the understanding of the contractor’s processes and overall risk, design procedures to test proposed allowable costs are related to only eligible dependents.</p> | |
| <p>14. IR&D/B&P. If the contractor is identified as a major contractor in the preliminary steps (DFARS 231.205-18(a)), verify the IR&D/B&P costs meet the allowability criteria in DFARS 231.205-18(c). Obtain Costs by Element for each IR&D/B&P project. For significant IR&D projects review the project descriptions, work documents, invention reports to determine if they meet the FAR 31.205-18 and CAS 420 definitions Applied Research, Basic Research, or Development.</p> | |
| <p>SUMMARIZE RESULTS</p> | |
| <p>15. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation. <i>[Note: If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.]</i></p> | |

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| I-1 | Inter-Organizational Transfers (IOTs) | WP Reference |
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| <p>Based on your understanding of the contractor’s IOT policies / procedures and risks perform the following steps for material and significant/sensitive IOTs. Coordinate with Field Detachment as necessary to address IOTs on classified contracts. <i>(Rely on prior audits to maximum extent possible for steps 2 and 3 such as proposal audits, prior incurred costs, or paid voucher audits in which specific IOTs may have already been tested).</i></p> | |
| <p>1. MAAR 10: Adjusting Entries and Exception Reports. Evaluate adjusting journal entries and exception reports for IOT costs. Identify adjustments requiring further analysis and explanation.</p> | |
| <p>2. Compliance with FAR 31.205-26(e). Determine if the selected IOTs were transferred and included in the incurred cost proposal based on costs incurred, as required by FAR 31.205-26(e). If the IOT was transferred and included in the incurred cost proposal based on price (cost plus profit), evaluate compliance with FAR 31.205-26(e)(1) and (2), which provides for an allowance based on price when:</p> | |
| <p>a. It is the established practice of the transferring organization to price inter-organizational transfers at other than cost for commercial work of the contractor or any division, subsidiary, or affiliate of the contractor under a common control; and</p> | |
| <p>b. The items being transferred qualifies for an exception under FAR 15.403-1(b) (supported by adequate price competition or sales data as applicable) and the contracting officer has not determined the price to be unreasonable.</p> | |
| <p>c. If requirements of FAR 31.205-26(e) were not met, question the amounts in excess of actual costs.</p> | |
| <p>3. Perform the following to assess allowability (FAR 31.201-2) of selected IOTs issued under flexibly priced prime contracts:</p> | |
| <p>a. IOT Agreement. Verify a proper agreement exists between the authorizing and performing organizations.</p> | |
| <p>b. Verify the scope of the work authorized and billed by the performing segment was needed for the prime / upper-tier contract. (FAR 31.201-4 – Determining Allocability)</p> | |
| <p>c. Determine if the IOT costs are reasonable (FAR 31.201-3) at the prime /upper-tier contract level.</p> <ul style="list-style-type: none"> • IOTs based on price – Consider testing performed in step 2b above. • Make or Buy Program. Determine if the contractor was required to submit a make or buy program as part of the | |

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| <p>solicitation relating to the IOT effort and whether the contracting officer reviewed and approved the make or buy program (FAR 15.407-2; 52.215-9). Evaluate the contractor’s make/buy decision for reasonableness. IOTs are considered a make a decision if reimbursement is based on cost and a buy decision if based on a competitive price. Be alert for decisions that were in the best interest of the contractor but not the Government. (CAM 9-405.2))</p> <ul style="list-style-type: none"> • If the contractor has little or no evidence to support reasonableness, consider alternate procedures that can be performed to test for reasonableness. <i>(Note: Costs should not be questioned if reasonableness cannot be established. If significant, a reservation on the engagement should be reported as well as the non-compliance with FAR 31.201-2(d).</i> • If the costs are deemed unreasonable, design procedures to develop an audit position on the unreasonable portion and question accordingly. | |
| <p>d. Based upon how IOT costs are booked/received by the prime segment, design procedures to ensure the proposed / billed IOT costs:</p> <ul style="list-style-type: none"> • Reconcile to performing segments books or billings (if submitted). | |
| <ul style="list-style-type: none"> • Are in compliance with contractual terms and IOT agreement (i.e., special limitations, T&M contracts - FAR 52.232-7 payment clause, etc.) <p><i>(Note: Depending upon the contractor’s specific practices, this may not be feasible without an assist.)</i></p> | |
| <p>4. MAAR 12. Incorporate any questioned costs from assist audits received on performing segments and follow-up on any outstanding assist audits.</p> | |
| <p>5. Summarize the results including the conclusions, basis of proposed cost, and audit evaluation.</p> <p><i>[Note: If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.]</i></p> | |

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| U-1 | Agency Compensation Team: Compensation Reasonableness and FAR Cap Allowability | WP Reference |
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| <p>Version 4.0, dated January 2021</p> | |
| <p align="center"><u>Up Front Communication and Planning</u></p> | |
| <p>1. Review the FAO’s request and accompanying data; then discuss the request with the requesting audit team. Verify that all required information is available now or will soon be provided, including:</p> <ul style="list-style-type: none"> • Position descriptions, • Market pricing surveys, • Outside consultant studies, • Compensation policies and procedures, etc. <p>If data is incomplete, make inquiries to determine when the data will be provided. If the data is unavailable, document the explanation and discuss with your supervisor the implications on the planned audit procedures.</p> | |
| <p>2. Review all FAO prepared materiality and/or risk documentation including inquiries, analytical analyses, etc. Coordinate with the FAO to clarify your understanding of materiality/risk, collaborate with the FAO to fine tune the materiality/risk conclusions, and document the rationale for the positions selected for further evaluation.</p> | |
| <p>3. Document your understanding of the contractor’s basis for proposed compensation, including justifications for setting compensation higher than market mean (e.g., financial performance, qualitative factors, etc.). Where the contractor used surveys or an outside consultant to establish compensation, document the contractor’s selected compensation levels, and whether the contractor used performance measures to establish compensation levels (quantitative, qualitative, or both).</p> | |
| <p><u>Evaluate Compensation Using FAR Limits</u></p> | |
| <p>4. Determine applicable FAR 31.205-6(p) Compensation Limitations. If the contractor did not propose a Blended Cap, proceed to b.</p> <p>a. Blended Caps. If the contractor proposed a blended Cap, review the advanced agreement, if available, and coordinate with the FAO to determine whether the rate computation was previously evaluated. Document any prior results and negotiation positions. Discuss with your supervisor and adjust risk and the planned procedures accordingly.</p> | |
| <p>b. For each individual selected, identify the applicable Cap, determine whether the proposed amounts comply, and classify costs in excess of the Cap as unallowable per FAR 31.205-6(p), prior to proceeding with the reasonableness testing.</p> | |
| <p><u>Evaluate Compensation Reasonableness</u></p> | |

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| <p>5. Thoroughly read each position description and determine whether it is sufficiently described to match a survey description. If inadequate, obtain other documents describing the position’s duties and functions. If it remains inadequate or altogether absent, document this fact, and discuss with your supervisor whether additional procedures are required to effectively match the position to survey data.</p> | |
| <p>6. Identify the best fit compensation survey for each selected job/position, finding the best match of the company’s revenue, industry, geographic location (area from which employees are recruited and lost), and participation by companies not performing government contracts. Adjust these factors considering the skill complexity of each tested position (e.g., advanced engineers are often recruited nationally while entry-level engineers are not).</p> <p>Apply professional skepticism before using a contractor provided survey, especially if you determine the contractor did not use the survey for its own market pricing, or if the contractor used a single survey to benchmark all position classifications. Document your rationale if choosing not to use the contractor-provided survey.</p> <p>Select the appropriate survey for each position classification and document your rationale.</p> | |
| <p>7. If the contractor sets base salary higher than market median, consider the merits of the justification, as well as the contractor’s financial performance, and document your conclusions.</p> <p>Determine the appropriate percentile for market pricing each position at the appropriate level, generally limited to the range between the 25th and 75th percentiles. Document the rationale for your determination.</p> | |
| <p>8. Determine if the contractor is following its established policy or procedure for issuing bonuses and the award of the bonus takes place.</p> | |
| <p>9. Update the survey amounts by applying the appropriate escalation factor to the mid-point of the contractor’s Fiscal Year.</p> | |
| <p>10. Appropriately consolidate the individual survey results.</p> | |
| <p>11. Determine if the company’s allowable fringe benefits are below market level. If below market, consider the prevailing circumstances before adding an “offset” equal to the difference between the company’s allowable fringe benefits and the market fringe benefits.</p> | |
| <p>12. Determine if the contractor is proposing Long Term Incentive (LTI) compensation, or whether the circumstances call for a LTI offset. Ensure any LTI is evaluated for allowability and</p> | |

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| <p>reasonableness. No offset consideration is necessary if you used a total direct compensation survey benchmark, or if LTI plans or LTI awards are not prevalent under the contractor’s circumstance (typically only prevalent when company sales > \$300 million).</p> <p>If LTI compensation is deemed appropriate, ensure it:</p> <ul style="list-style-type: none"> • Only includes allowable cost components, • Is founded using a reasonable base salary, and • Is consistent with the best-fit survey data. | |
| 13. For each selection, compare the proposed compensation to the reasonable compensation level and question the difference. | |
| <u>Summarize and Communicate Results</u> | |
| 14. For each selection, document the conclusion, basis of proposed cost, and audit evaluation. Provide the FAO the documentation necessary to understand the evaluation, and to meet our professional standards. | |
| 15. Communicate the results with the FAO audit team and discuss the findings with the contractor as appropriate. Address questions and contractor rebuttals as necessary through the FAO. If significant exceptions, offer to attend negotiations. | |

| A-1 | Concluding Steps | WP Reference |
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| Version 4.0, dated January 2021 | | |
| 1. | Summarize and document the audit results and identify the requirements of the audit opinion and using professional judgment select the appropriate opinion based on the evidence obtained. Consider quantitative and qualitative materiality for misstatements (e.g. questioned costs) taken individually, and in aggregate, when evaluating the type of opinion. | |
| 2. | Obtain supervisory review of the working papers, and draft audit results section of the audit report before discussions with the contractor. | |
| 3. | Prepare the draft rate agreement letter, Cumulative Allowable Cost Worksheet (if applicable), and audit report in accordance with Agency guidance and obtain supervisory review. Ensure you include any assist audits received in Section II of the Cumulative Allowable Cost Worksheet. | |

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| <p>4. Auditors should document and communicate with the contracting officers upon the completion of our audit and approval of the supervisor:</p> | |
| <p>a. Brief the contracting officer on significant questioned, unsupported, unresolved costs or other significant and/or complex findings/issues, and/or</p> | |
| <p>b. Coordinate with the contracting officer to find out and determine if inclusion of detailed explanatory notes in our report would serve a useful purpose when there are no findings.</p> | |
| <p>5. Conduct an exit conference and provide the audit result to the contractor. The contractor’s reaction should be obtained for inclusion in the final draft audit report.</p> | |
| <p>6. Calculate the total questioned costs considered to potentially expressly unallowable costs subject to penalty on covered contracts. Coordinate with the contracting officer (or cognizant auditor) to determine the reporting detail necessary for the contracting officer to make a penalty determination (e.g., Explanatory Notes, Explanatory Notes & Exhibit, etc.) At a minimum, the report should identify questioned costs potentially subject to penalty and include supporting rationale (FAR 42.709-2(b)).</p> | |
| <p>7. If the contractor does not agree with the questioned cost(s) draft a DCAA Form 1 in accordance with CAM 6-900.</p> <p><i>[Note: Questioned cost for subcontract effort that is not concurred should be resolved at the prime level (prime contractor and prime’s CFAO) using DCAA Form 1 procedures (CAM 6-900). FD Auditors will prepare and send Form 1s applicable to classified contract customers.]</i></p> | |
| <p>8. Prepare any required audit lead sheets and submit to supervisor for approval. Update permanent files and risk determination for next fiscal year based on findings/audit results. Determine if the DMIS risk classification requires an update.</p> | |
| <p>9. Prepare and verify accuracy of dollars examined, questioned costs, and sustained questioned costs amounts for DMIS reporting.</p> | |
| <p>10. If significant instances of CAS noncompliances are found, coordinate and discuss with supervisory auditor and report under activity code 19200 in accordance with Agency guidance.</p> | |

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| <p>11. If we identify a business system deficiency during the incurred cost audit, open an 11090 assignment to determine if the deficiency still exists today, and to fully develop and report material weaknesses/significant internal control deficiencies.</p> <p><i>(Note: The issuance of the incurred cost audit is not dependent on the results of the 11090)</i></p> | |
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