

Master Document – Audit Program

Activity Code 19407		Compliance Audit CAS 407
Version 5.0, dated April 2004		
B-1	Planning Considerations	
Purpose and Scope		
<ol style="list-style-type: none"> 1. The purpose of CAS compliance auditing is to determine if the contractor's policies, procedures, and practices used to estimate, accumulate, and report costs on Government contracts and subcontracts comply with the requirements of CAS. CAS 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 generally be limited to the current contractor fiscal year (CCFY). Testing of prior years' transactions, especially unaudited fiscal years, is acceptable to assure that no system changes were made and no noncompliances exist. For efficiency, CAS compliance testing, if possible, should be performed concurrently with tests for compliance with FAR and contract terms. Some level of transaction testing should be performed if the standard/provision of the standard are material. 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. 		
Other Planning Considerations		
<ol style="list-style-type: none"> 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. 		

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<p>However, contractors are required to follow provisions of CAS 407 if they choose to cost Government contracts through a standard cost accounting system. The decision not to test for CAS compliance or for compliance with specific provisions of the standard should be documented. See CAM 8-305, CAS Compliance Testing.</p>
<p>2. Materiality (see 48 CFR 9903.305) and audit risk assessment (including Internal Control Audit Planning Summary (ICAPS) for major contractors, ICQ for nonmajors, and historical CAS problems) are integral parts of the planning process and should be considered in developing the extent and frequency of CAS compliance tests.</p>
<p>3. Auditors should assess the materiality of the standard in relation to the contractor’s CAS covered contracts. If the standard is not applicable to the contractor or noncompliance with the standard overall has no significant impact on Government contract costs, there is no need to test whether the contractor is complying with the standard. See DoD CAS Working Group Guidance Paper 76-7 which regards applicability and effective dates in the standards. If CAS 407 is applicable and material to the Government, the auditor should assess which provisions of the standard are significant to the contractor; the extent reliance may be placed on the contractor's system of internal controls to ensure compliance; and the results of other relevant audits (e.g., results of prior compliance audits, Disclosure Statement revisions, etc.).</p>

B-1	Preliminary Steps	WP Reference
	Version 5.0, dated April 2004	
	1. Research and Planning	
	a. Read and become familiar with the criteria in CAS 407, CAM 8-407, and any recent Headquarters guidance not incorporated in CAM.	
	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, whether 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)).	

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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.	
e. Examine the FAO permanent files (including ICAPS or ICQ, audit leads from other relevant audits, and MAARs Control Log) and prior audit workpackages 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.	
f. Discuss the planned compliance audit with the administrative contracting officer and, if appropriate, other customers to identify, understand, and document any concerns they may have or areas, which should be evaluated.	
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.	
(8) Discussing any identified weaknesses which may have been reported and related follow-up actions.	
b. If reliance is to be placed on the work of others, the file should contain the required documentation (see CAM 4-1000).	

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3. Risk Assessment	
a. Examine the ICQ or relevant ICAPS (whichever is applicable), to obtain information regarding accounting system adequacy, identify any known outstanding system deficiencies, and perform preliminary assessment of risk. Document results.	
b. If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained during the audit is highly dependent on computerized information systems, document on working paper B-2 the audit work performed that supports reliance on the computer-based evidential matter. Specifically, document or reference one or more of the following on working paper B-2:	
(1.)the audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits,	
(2.)the procedures/tests that will be performed in this audit to evaluate the incurred costs that will also support reliance on the evidential matter, and/or	
(3.)the tests that will be performed in this audit that will be specifically designed to test the reliability of the computer-based data,	
When sufficient work is not performed to determine reliability (i.e., reduce audit risk to an acceptable level), qualify the audit report in accordance with CAM 10-210.4a and 10-807.3.	
c. Document assessment of the contractor’s internal control structure relative to this standard (control environment, accounting system, and relevant policies, procedures, and practices) to assure compliance with laws and regulations.	
d. 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.	

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e. In planning and performing the examination, review the fraud risk indicators in CAM Figure 4-7-3 for applicability to this audit. Document in working paper B any identified fraud risk indicators and your response/actions to those identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.	
f. From the information gathered in the preceding steps and using the materiality criteria in 48 CFR 9903.305, assess the audit risk and determine the scope of audit and extent of compliance testing to be performed.	
g. Discuss with the CAS Technical Specialist and/or Supervisory Auditor the scope of the audit. If the standard/provision of the standard is not applicable or is immaterial, assess whether the audit should be curtailed. Document the decision to continue/ curtail the audit of the provision/ standard.	
h. Update the information in the permanent files as needed.	

C-1	Basic Requirements	WP Reference
Version 5.0, dated April 2004		
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).	

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(2) Verify that standard costs and related variances are accounted for at the production level.	
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"> • For all products in one grouping, 	
<ul style="list-style-type: none"> • By product, 	
<ul style="list-style-type: none"> • By assembly or subassembly, or 	
<ul style="list-style-type: none"> • By part. 	
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)).	
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	

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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.	
(This step would partially satisfy MAARS No. 9 if labor distribution entries were traced to and from the cost accumulation records and/or MAARS No. 10 and/or 11 if allocation of variances recorded via labor and/or material adjusting entries were evaluated.)	

D-1	Standard Costs for Labor	W/P Ref.
Version 5.0, dated April 2004		
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.	
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 technical assistance as needed.	
3.	When a labor-rate standard is set to cover a group of direct labor workers who perform disparate functions, determine that:	
	a. The group of workers all work in a single production unit yielding homogeneous outputs; or	
	b. The group of workers, in performance of their respective functions, forms an integral team (CAS 407.50(a)(4)).	
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 for each	

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production unit (CAS 407.50(c)).	
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E-1	Standard Costs for Material	W/P Ref.
Version 5.0, dated April 2004		
1.	Verify that the actual and disclosed practices are consistent and comply with the following	
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)).	
b.	Material-quantity variances are recognized at the point material costs are allocated to production units.	
2.	Test variances actually recorded to verify that they are calculated properly (against correct standards) and distributed appropriately.	
	(This step would partially satisfy MAARs No. 11, if allocations of variances were made via adjusting entries and the auditor audited the adjusting entries.)	
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"> • Adjusting the purchased-item inventory (ending inventory) from standard cost to actual cost, then allocating the balance of the price variance to 	

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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	
<ul style="list-style-type: none"> • 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)). 	
(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))	
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)).	

F-1	Disposition of Variances	W/P Ref.
Version 5.0, dated April 2004		
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.	

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A-1	Concluding Steps	WP Reference
Version 5.0, dated April 2004		
1.	Summarize the results of audit.	
2.	Discuss results with the supervisor or the FAO technical specialist. The auditor should only report those noncompliances which are considered material (see CAM 8-302.7).	
3.	Coordinate significant or unusual issues with the CFAO, FAO Manager, and if applicable, with the CAC, CHOA, or GAC network (see CAM 8-302.4 & 8-302.6). Coordination should be both before and after discussion of results with the contractor. The CFAO should be apprised of noncompliance matters at the earliest possible date. If a noncompliance is considered immaterial, recommend to the CFAO that the contractor be notified to reserve the Government's right should the cost impact become material (see FAR 30.602).	
4.	Prepare draft audit report in accordance with CAM 10-807 (activity code 194XX) when no instances of noncompliances are found, or CAM 10-808 (activity code 19200) when instances of noncompliances are found. Ensure the audit report scope includes only those costs or provisions of the standard covered by the audit.	
5.	Conduct an exit conference with the contractor in accordance with CAM 4-304.	
6.	Finalize audit report incorporating the contractor's response and audit rejoinder, if applicable.	
7.	Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented (e.g., by initials and date on the CD or working paper folder, etc.) and should include	
a.	The title, author, and keywords fields of the file properties in the audit report must be completed (for the audit report only) prior to final filing.	
b.	Review the APPS exe file for size. APPS-generated executable files that are over 10 megabytes in size should be reviewed to ensure that the format and content justify the size. Supervisors are responsible for reviewing or designating someone to review these files for content and format.	
c.	Review the APPS exe file for temporary files. These files can be recognized by the “~\$” or “~WRL” at the beginning of the file name. Once the APPS exe file is complete and there is NO	

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<p>ACTIVITY to be completed on any of the files contained within the exe file, any temporary files should be deleted so there are no unintentional versions of working papers and/or reports. NOTE: This should be done prior to invoking the Export/Archive Option in APPS.</p>	
<p>d. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should be password protected. The electronic file should then be renamed according to the convention “01 DCAA Report [RORG-ASSIGNMENT NO.] – Final.doc” and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes. For Memorandums the word “Report” would be replaced by “MFF” or “MFR” in the naming convention as appropriate.</p>	
<p>e. When the audit report is transmitted electronically to the requestor, the transmission email should be saved as a txt file (this will ensure the attachments are not saved again). Saving delivery or read receipts is optional. If saved, the naming convention should distinguish them from transmittal emails.</p>	
<p>f. Once the report is signed, the signature page of the audit report must be scanned in accordance with Agency standard scanning instructions. For audit packages, the scanned signature page file should be named the same as the audit report (see above) with “-sig” added (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.pdf). There is no requirement to make the file a part of the APPS generated executable file and it must be included separately in the iRIMS folder. There is no need to scan the signature page of a Memorandum unless it is distributed outside of DCAA.</p>	
<p>g. Ensure an electronic copy of the final draft audit report containing the supervisory auditor’s initials and date, cross-referenced to the working papers, is included in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.</p>	
<p>h. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.</p>	
<p>i. Two complete sets of electronic working papers should be filed. One set (official) will be filed in iRIMS. A second set (backup) will be stored on removable media in the hard copy working paper folder. The new APPS naming convention (ex: 01701_2003A10100001_Archive_093003.exe) will be used</p>	

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<p>for both. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.</p>	
<p>j. Verify using a separate machine, that electronic files stored on removable media are not corrupted and can be unarchived. Indicate the test was successful by placing tester initials and date prominently on the CD label.</p>	
<p>k. Securely enclose the “backup” set of electronic files (CD) and any “official” set of hard copy in the hard copy folder.</p>	
<p>l. File the “official” set of electronic files in iRIMS (see iRIMS User Guide).</p>	
<p>m. <u>Do Not File Sensitive Audits in iRIMS</u>: Sensitive audits include but are not limited to classified work, suspected irregular conduct, hotline or DCAA Form 2000 related files. These audits should not be filed in iRIMS at this time. See CAM 4-407f for filing instructions</p>	
<p>8. Update the permanent files, ICAPS or ICQ, and Mandatory Annual Audit Requirements (MAARs) schedules. As a minimum, consider updating those ICAPS and/or ICQ sections and MAARs identified in the Preliminary Audit Steps. <i>Ensure that a copy of DMIS Report No. CAS 3 entitled “Compliance Testing (Activity Code 194XX)” is included in the permanent file.</i></p>	