



DEFENSE CONTRACT AUDIT AGENCY
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IN REPLY REFER TO

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MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA
HEADS OF PRINCIPAL STAFF ELEMENTS, DCAA

SUBJECT: Audit Alert on Reviewing Projected Pension Costs

SUMMARY

This memorandum provides guidance on auditing pension costs in forward pricing proposals. Due to the recent global stock market decline, Government contractors' defined benefit pension plans may have become underfunded or barely fully funded, which may necessitate contractors to increase their annual contributions to the pension plans.

Auditors should request the assistance of the DCMA CIPR Center when auditing significant pension costs included in forward pricing proposals. The CIPR Center can be reached by calling 718-354-3767 or e-mail to CIPRInbox@dcma.mil. This is particularly important when the projected pension costs are significantly increased from prior years and when the plan is near full-funding status. An increase in projected pension costs resulting from the contractor's use of an interest rate lower than the assumed long-term rate of return and immediate recognition of the investment loss experienced in the recent months should be questioned.

BACKGROUND

Discussions with DCMA and information received from certain Field Audit Offices revealed that the decline in the stock market in 2008 resulted in many previously over-funded defined benefit pension plans becoming underfunded or barely fully funded. Accordingly, we expect that many contractors will either increase projected pension costs from prior years or include pension costs for plans that are no longer fully funded. In some cases, the contractor's projected pension costs were calculated using practices that were not compliant with the requirements of CAS 412 and CAS 413, resulting in increased pension costs included in the forward pricing proposals.

GUIDANCE

Auditors should request the assistance of the DCMA CIPR Center when auditing forward pricing proposals that include significant pension costs. The DCMA CIPR Center's assistance is particularly important when the projected pension costs are significantly increased from prior years and when the plan is underfunded or barely fully funded.

SUBJECT: Audit Alert on Reviewing Projected Pension Costs

Auditors should continue to test contractor compliance with CAS 412 and 413 during forward pricing rate audits when significant pension costs are proposed. Auditors should question increased pension costs resulting from the contractor's use of an interest rate lower than the assumed long-term rate of return in computing the present value of plan benefit liabilities, and in estimating the return on pension plan assets. Auditors should cite CAS 412.50(b)(4) as a basis for questioning the costs and issue a CAS noncompliance report. CAS 412.50(b)(4) requires the contractor to use its assumed long-term rate of return so as to "avoid distortions caused by short-term fluctuations." In addition, the assumed long-term rate of return should be used in determining if projected pension costs are subject to the assignable cost limitation at CAS 412.30(a)(9); that is, if the actuarial value of plan assets exceeds the actuarial accrued liability plus current normal costs, then no pension costs are allocable to government contracts.

Auditors should question the contractor's immediate expensing of the investment losses in 2008 and issue a CAS noncompliance report. These losses represent actuarial losses that are required to be amortized over 15 years as a component of annual pension costs in accordance with CAS 413.50(a)(2). Accordingly, the contractor's projected pension costs should include only one-fifteenth of these investment losses per year plus interest on the unamortized balance.

Auditors should be aware that many contractors have established a practice of averaging pension asset values over a three to six year period that will mitigate the impact of the recent significant decline in the value of pension assets. If the contractor used a different asset valuation method in estimating pension costs from its established method, the auditor should determine if the changed method is reasonable and acceptable in consultation with the DCMA CIPR Center. If the new method is determined reasonable and acceptable, the change should be processed as a voluntary accounting change in accordance with FAR 52.230-2(a)(4)(ii), which prohibits any increased costs paid by the Government.

Additionally, auditors are reminded to comply with MRD 07-PAC-013(R), dated May 1, 2007, Subject: Audit Guidance on the Impact of the Pension Protection (PPA) Act of 2006. This MRD transmitted DoD policy that requires contractors to continue to comply with CAS 412 and CAS 413, even though contractors may make increased pension plan funding mandated by the PPA.

Finally, auditors should refer to guidance at CAM 7-606 d., e., and f. for pension plans that are at or near fully-funded status. In addition, CAM 9-703.8 b.(5) provides further guidance on auditing projected pension costs when the contractor's pension plan is at or near fully-funded status.

CONCLUDING REMARKS

FAO personnel should direct questions regarding this memorandum to their regional offices. Regional offices should direct their questions to Accounting and Cost Principles Division, at (703) 767-3250 or by e-mail to DCAA-PAC@dcaa.mil.

/Signed/
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