

## Master Document – Audit Program

<b>Activity Code 19413</b>	<b>CAS 413.50(c)(12) Segment Closing Adjustments</b>
<b>Version 2.7, dated November 2009</b>	
<b>B-1</b>	<b>Planning Considerations</b>
NOTE: This assignment must be tailored to the requirements of each evaluation, based on the treatment of pension assets/liabilities attributable to the closed segment. In almost all cases, the evaluation of pension cost in connection with segment closings will be accomplished as a joint effort between DCAA and DCMA. Accordingly, the audit steps performed should reflect a mutual understanding between the CIPR team chief, the lead Insurance/Pension Specialist, the auditor, and the supervisor as to the scope required to meet Government Auditing Standards, and DCMA and DCAA objectives for the pension evaluation assignment.	
<b>Purpose and Scope</b>	
The purpose of this evaluation is to determine whether the contractor has properly calculated the amount of pension assets and liabilities attributable to the closed segment as the basis for measurement of the adjustment to previously determined pension cost required under CAS 413.50(c)(12). The contractor's accounting for pension assets/liabilities must comply with the measurement and allocability requirements of Cost Accounting Standards 412 and 413, and must be allocable, reasonable, and allowable per the applicable provisions FAR Subpart 31.2. DCAA and DCMA have a joint responsibility for the audit/review of pension cost; thus, the scope should be established accordingly.	
The audit steps cover the key aspects of accounting for pension assets and liabilities for segment closings, benefit curtailments and plan terminations. Full implementation of the audit steps requires (1) knowledge of the basic concepts of pension accounting, (2) familiarity with actuarial terminology, (3) understanding of CAS 412, 413, and FAR 31.205-6(j) requirements, and (4) knowledge of pension accounting principles in FASB Statement Nos. 87 and 88 and related Interpretations. The team members should have a full understanding of the contractor's system of accounting for pensions and the methods used for funding and allocation of pension costs.	
The standard steps are not intended to be all inclusive. However, the review/audit steps listed are considered necessary, if applicable, to provide an unqualified opinion on the contractor's compliance with CAS 413.50(c)(12). The review/audit should be supplemented as necessary to cover additional areas unique to individual segment closings.	
<b>Pre-planning Team Meeting</b>	
The DCMA/DCAA team members will coordinate on the nature and objectives of the audit/review, noting any specific requirements. DCAA is responsible for performing contract audit responsibilities related to CAS. The team will also identify any audit/review steps necessary to satisfy specific information requested by the cognizant Federal agency official	

**Master Document – Audit Program**

(CFAO), who is usually the ACO. The team will then prepare a consolidated data request for the contractor, listing the data and documents necessary to accomplish the joint audit/review objectives. The team will decide which team member or agency will issue the final report to the CFAO.

**Reporting CIPR Results**

Each agency will perform their portion of the CIPR program, however, only one CIPR report will be issued to the CFAO. The CIPR report will normally be issued by the team leader and incorporate the results of the other team member’s report and include it as an attachment.

**References**

1. FAR 31.205-6(j) - Pension Costs
2. FAR 52.216-7 - Allowable Cost and Payment Clause
3. FAR 52.232-16 - Progress Payments
4. CAS 412 - Composition and Measurement of Pension Cost
5. CAS 413 - Adjustment and Allocation of Pension Cost
6. DCAA Contract Audit Manual (CAM) 7640.1
  - a. 7-600, Section 6 - Pension Costs
  - b. Topical Index References – Pension
7. DCMA Guidebook, located under “eBusiness” at <http://www.dema.mil>
8. Internal Revenue Code Section 414 - Regulation 1.414(l)-1 - Mergers and Consolidation of Plans or Transfers of Plan Assets
9. Employee Retirement Income Security Act of 1974 (ERISA)
10. Generally Accepted Actuarial Practices and Procedures as Promulgated by the Actuarial Standards Board
11. FASB 87 & 88
12. Contractor Asset Purchase/Sales Agreement (if applicable)
13. CAM Appendix D, Technical Specialist Assistance

<b>B-1</b>	<b>Preliminary Steps</b>	<b>Responsible</b>	
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**Master Document – Audit Program**

	Agency	WP Reference
<b>Version 2.7, dated November 2009</b>		
1. Consider CAM 7-600, CAM 8-412 and CAM 8-413, and subsequent Headquarter’s guidance, memorandums and regional instructions.	DCAA	
2. Consider DCMA Guidebook and subsequent DCMA guidance memorandums.	DCMA	
3. Evaluate information in the permanent pension file, or obtain, the following:	DCMA/DCAA	
a. Provisions of the pension plan(s) and early retirement plans.	DCMA/DCAA	
b. Audit & CIPR reports on contractor's pension costs.	DCMA/DCAA	
c. Contractor's CAS Disclosure Statement(s). [Note: During the performance of the detailed audit steps, auditors should determine that actual practices are consistent with disclosed practices.]	DCMA/DCAA	
d. Actuarial reports.	DCMA/DCAA	
e. DOL/IRS Form 5500, including Schedules A & B for actuarial information.	DCMA/DCAA	
f. Pension Trust's annual report.	DCMA/DCAA	
g. Written summary of contractor's pension accounting and funding practices and statistics of pension costs allocated to Government contracts.	DCMA/DCAA	
h. Contractor's internal and independent auditors' reports on pension plan activities.	DCMA/DCAA	
i. Contract clauses and advance agreements on pension cost (when applicable).	DCMA/DCAA	
j. Information in memorandums of negotiation covering pension costs.	DCMA/DCAA	
<b>(Note: This information should be updated in the permanent file during or at the conclusion of the audit)</b>		
4. Evaluate the Internal Control Audit Planning Summary for related contractor systems to identify previously noted deficiencies, which could impact the scope of the current audit. If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained	DCMA/DCAA	

**Master Document – Audit Program**

<p>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 in working paper B-2:</p>		
<p>a. The audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits.</p>		
<p>b. 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</p>		
<p>c. The tests that will be performed in this audit that will be specifically designed to test the reliability of the computer-based data.</p>		
<p>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 or CAM 10-807.3, whichever is applicable in this circumstance.</p>		
<p>5. In planning and performing the examination, consider the fraud risk indicators specific to the audit. The principal sources for the applicable fraud indicators are:</p> <ul style="list-style-type: none"> <li>• Handbook on Fraud Indicators for Contract Auditors, Section II (IGDH 7600.3, APO March 31, 1993) located at <a href="http://www.dodig.mil/PUBS/igdh7600.doc">http://www.dodig.mil/PUBS/igdh7600.doc</a> (To access the handbook, copy and paste the web address shown above into the address block in Internet Explorer.)</li> <li>• CAM Figure 4-7-3</li> </ul> <p>Document in working paper B any identified fraud risk indicators and your response/actions to the 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.</p>	<p>DCAA</p>	
<p>6. Perform risk assessment and establish scope by designating the detailed audit/review steps identified</p>	<p>DCMA/DCAA</p>	

**Master Document – Audit Program**

below to be performed by each DCMA/DCAA team member. Supplement the detailed audit steps with any additional audit steps necessary.		
7. Coordinate with division CFAO/FAO(s) and request any assistance necessary for calculation of the segment closing adjustment. Obtain copy of final sales/purchase agreement if applicable.	DCMA/DCAA	
8. Attend the entrance conference with the contractor.	DCMA/DCAA	
9. If the segment closing involved the transfer of pension assets/liabilities to buyer contractor, prepare a detailed summary of the current pension issues for the CAC/FAO that has assumed responsibility for the pension evaluations (CAM 7-603 b.). The summary should include data on the funding status of the plan and any information from the sales agreement on the disposition of the acquired pension plan.	DCMA/DCAA	
10. In the event that the sales agreement or other documentation indicate that the buyer contractor plans to merge the plan, the assuming FAO and CFAO should be notified and determine the buyer's compliance with CAS 413.50(c)(3), i. e., if the ratio of assets to actuarial liabilities of the plans prior to merger are materially different, the pension cost must be accounted for on a segmented basis.	DCMA/DCAA	

<b>C-1</b>	<b>Qualified Defined Benefit Plans</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.7, dated November 2009</b>			
1.	If a segment is closed due to sale or transfer of ownership:		
a.	Examine the sales/purchase agreement and identify provisions addressing the treatment of pension assets and liabilities for the divested segment.	DCAA Lead	
b.	Evaluate terms of sales agreement and identify any potential CAS/FAR issues that should be addressed.	DCAA/DCMA	
2.	In the event of a segment closing or curtailment of benefits, evaluate contractor's calculation of the		

**Master Document – Audit Program**

Actuarial Liability using the following steps:		
a. Determine date of event that triggered requirement for calculation of CAS 413.50(c)(12) adjustment.	DCAA	
b. Determine that the calculation of the liability was made as of the date of the event that triggered the segment closing or curtailment of benefits (CAS 413.50(c)(12)(iii)).	DCMA	
c. Verify that the calculation of the actuarial liability was made using the accrued benefit cost method, i.e., no projections for future salary increases (CAS 413.50(c)(12)(i)).	DCMA	
d. Determine that actuarial assumptions employed are consistent with the current and prior long term assumptions used in measurement of pension costs (CAS 413.50(c)(12)(i)).	DCMA Lead	
e. Analyze pension plan changes and verify that increased liabilities due to plan improvements adopted within 60 months of the segment closing date are prorated over a 60 month period (CAS 413.50(c)(12)(iv)).	DCAA Lead	
f. Determine that the liability used in calculating the pension adjustment does not include any prior unfunded costs, or other previously disallowed costs.	DCAA Lead	
g. Ensure that calculation of the actuarial liability for the closed segment was based on the proper census data applicable to plan participants, including both active and retired employees.	DCMA	
h. Ascertain whether the segment closing triggered the payment of early retirement benefits. If so, verify that increased liabilities are computed in accordance with plan provisions and allocated based on causal/beneficial criteria.	DCAA Lead	
3. Evaluate the contractor’s calculation of the market value of trust fund assets allocated to the closed segment using the following steps:		
a. For contractors using composite accounting, verify that a portion of the undivided assets are allocated to the closed segment in accordance with requirements of CAS 413.50(c)(5)(i) or	DCMA	

**Master Document – Audit Program**

413.50(c)(5)(ii) using the following steps:		
(1) Determine if data is readily determinable so that the market value of trust fund assets can be allocated to the closed segment based on the actual amount of funds contributed on behalf of the segment, adjusted for investment return and decreased for expenses and benefits paid from such funds (CAS 413.50(c)(5)(i)).	DCMA	
(2) If the data is not readily determinable, verify market value of fund assets are allocated based on the ratio of the closed segment’s actuarial liability to the plan’s total actuarial liability (CAS 413.50(c)(5)(ii)).	DCMA	
(3) Verify that the market value of assets is as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits or as of the date agreed on by the contracting parties (CAS 413.50(c)(12)(iii)).	DCAA	
(4) If assets are allocated pursuant to CAS 413.50(c)(5)(ii), ensure that the actuarial cost method used to calculate the liability is consistent with method or methods used to compute prior years’ pension costs.	DCMA	
(5) If the information necessary to determine actual contributions is determinable for only a few years prior to the closing, verify that the contractor used the CAS 413.50(c)(5)(ii) methodology to initially allocate assets to the earliest year for which information is available and thereafter brought the assets forward in accordance with provisions prescribed in 413.50(c)(7) (CAS 413.50(c)(5)(ii)).	DCMA	
b. For contractor’s that use segment accounting and have separately accounted for pension assets by segment, determine the accuracy of the segment’s asset value by tracing the asset values to actuarial reports and trust statements. Asset values should be on the date of the segment closing.	DCAA	
c. For contractors using either composite or segment accounting, perform the following steps:	DCMA	

**Master Document – Audit Program**

<p>(1) Ensure that the assets allocated to the segment are adjusted upward for the remaining balance of any unfunded liability that was separately identified and maintained pursuant to the requirements of CAS 413.50(c)(12)(ii).</p>	<p>DCMA</p>	
<p>(2) Determine if there is a shortage of allocated assets due to lost earnings resulting from contractor’s failure to fund pension costs on a quarterly basis. If there is a shortage, adjust the asset value to assure the calculated adjustment does not include recovery of the unallowable amount.</p>	<p>DCMA</p>	
<p>(3) Verify that the market value of trust fund assets has been reduced by the accumulated value of prepayment credits, if any (CAS 413.50(c)(12)(ii)).</p>	<p>DCAA</p>	
<p>(4) Determine if there is a shortage of trust fund assets due to withdrawal of pension assets for payment of other employee benefits unless authorized by an advance agreement in accordance with FAR 31.205-6(j)(2)(v).</p>	<p>DCAA</p>	
<p>(5) Determine if there is a shortage of trust fund assets due to contractor’s retention of unfunded liabilities related to previously closed commercial segments.</p>	<p>DCAA</p>	
<p>4. Determine if the contractor retained all or a portion of the pension assets and liabilities of the closed segment. If so, verify that calculation of the pension adjustment includes all retained pension assets and liabilities attributable to the closed segment including both active and inactive plan participants (CAS 413.50(c)(12)(v)).</p>	<p>DCAA</p>	
<p>5. Determine if the agreement to retain the liability for accrued benefits provide for payment of benefits based on future salary increases. If so, question any increased liability due to projected salary escalation.</p>	<p>DCAA Lead</p>	
<p>6. Determine the contractor’s prior practice of accounting for pension assets and liabilities attributable to previously closed commercial/ Government segments, if any.</p>	<p>DCAA</p>	
<p>7. Ensure that unfunded liabilities from prior years closed commercial segments were not allocated to</p>	<p>DCAA</p>	

**Master Document – Audit Program**

Government contracts.		
8. Determine if there has been any mass transfer or migration of employees among segments in prior years that would have a material impact on calculation of the segment closing adjustment. If so, adjust the assets/liabilities to reflect impact on calculation of the adjustment amount.	DCAA Lead	
9. Evaluate the contractor’s calculation of the Government’s share of the adjustment amount to ensure that it reflects the Government’s historical participation in contributions to the pension plan for a representative period as required by CAS 413.50(c)(12)(vi).	DCAA	
10. If an adjustment is due to contractor’s termination of a defined benefit plan:		
a. Verify that the actuarial liability is determined by amounts paid participants and insurers to irrevocably settle all benefit obligations (CAS 413.50(c)(12)(i)).	DCAA Lead	
b. Ensure that the Government’s share of any reversionary assets is computed in accordance with the formula prescribed in CAS 413.50(c)(12)(vi).	DCAA Lead	

<b>D-1</b>	<b>Non-Qualified Defined Benefit Plans</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.7, dated November 2009</b>			
1.	For a contractor that has any nonqualified defined benefit plans in which the pension costs allocated to Government contracts were measured and assigned using accrual based accounting, perform the following steps:		
a.	Obtain and verify schedule from contractor of the amount of pension cost accruals assigned and allocated to the closed segment since plan inception.	DCAA Lead	
b.	Calculate the amount of unfunded pension cost (imputed assets) based on the difference between the accrued amount and the amount of benefits paid to retirees/ beneficiaries.	DCAA	

**Master Document – Audit Program**

c. Add the value of the imputed assets determined in step “b” above to the amounts funded and accumulated value of permitted unfunded accruals as determined under the applicable CAS rules.	DCAA Lead	
d. Verify that the contractor calculated the actuarial liability using the accrued benefit cost method, i.e., no projected salary increases.	DCMA	
2. Ensure that the Government’s share of the adjustment amount is based on historical participation in pension costs accrued for non-qualified plans.	DCAA	
3. Compute any prior years adjustments due to CAS non-compliances, advance agreements and transition adjustments.	DCAA	
4. Reconcile the accrued cost for non-qualified plans with actuarial reports.	DCAA	
5. Verify segment closing adjustments for corporate and home office salaried employees are allocated to cost objectives using the same base that the contractor’s pre-closing pension cost accruals were allocated.	DCAA Lead	

<b>A-1</b>	<b>Concluding Steps</b>	<b>Responsible Agency</b>	<b>WP Reference</b>
<b>Version 2.7, dated November 2009</b>			
1.	Summarize the results of the review/audit and conduct initial exit conference with contractor.	DCMA/DCAA	
2.	Prepare draft report in accordance with Agency guidance.	DCMA/DCAA	
3.	Provide copy of draft report to CFAO and to contractor for comments.	DCMA/DCAA	
4.	Review contractor’s comments, if any, and finalize the report.	DCMA/DCAA	
5.	Forward final report to contracting officer.	DCMA/DCAA	
6.	The team leader will follow up on CIPR recommendations with the CFAO and provide supplemental assistance.	Team Leader	
7.	If an internal control system deficiency is detected during the course of this audit, draft a flash internal control report and submit it to the contractor for comment in accordance		

**Master Document – Audit Program**

with CAM 10-413.		
<b>8.</b> Update the permanent files. <i>Ensure that a copy of DMIS Report No. CAS 3 entitled “CAS Compliance Testing (Activity Code 194XX)” is included in the permanent file after the assignment has been closed in DMIS.</i>		