

DCAA MEMORANDUM FOR REGIONAL DIRECTORS COVER SHEET

AUDIT GUIDANCE/AUDIT MANAGEMENT GUIDANCE MEMORANDUM NO. 05-PAC-055(R)
August 25, 2005

Date of MRD:

Subject of MRD: Audit Guidance on Including Inactive Employees in the Calculation of CAS 413.50(c)(12) Pension Segment Closing Adjustments

Current Audit Guidance and/or Audit Management Guidance Affected:
CAM

Paragraph	Explanation of Effect on Current Version of CAM
8-413.3	<u>Incorporate guidance on verifying that all assets and liabilities are included in the calculation of the segment closing adjustments, including those related to inactive participants.</u>

AUDIT PROGRAMS

5 Digit Activity Code	Subactivity/Document Name	Step No.	Explanation of Effect on Current Audit Program
19413	<u>CAS 413.50(c)(12) Segment Closing Adjustments</u>	<u>C-1, 2.g. & 4.</u>	<u>Clarify that assets and liabilities of both active and inactive plan participants are included regardless of the contractor's pension accounting methodology.</u>

SHELL AUDIT REPORTS

5 Digit Activity Code	Subactivity/Document Name	Sec./Par.	Explanation of Effect on Current Audit Report
<u>N/A</u>			

MEMORANDUMS FOR REGIONAL DIRECTORS

MRD No.	Date	Subject/Explanation of Change
<u>N/A</u>		

INTERNAL CONTROL QUESTIONNAIRE/INTERNAL CONTROL MATRIX/INTERNAL CONTROL AUDIT PLANNING SUMMARY

ICQ/ICM/ICAPS	Section & No.	State Control(s) Affected by the Change
<u>N/A</u>		

DCAA PAMPHLETS/REGULATIONS/INSTRUCTIONS

DCAAP/R/I/No.	Date	Page/Sec./Par.	Explanation of Effect
<u>N/A</u>			

DMIS USER GUIDE

Explanation of Effect
<u>N/A</u>



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAC 730.3.B.08/2005-06

August 25, 2005
05-PAC-055(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Including Inactive Employees in the Calculation of
CAS 413.50(c)(12) Pension Segment Closing Adjustments

Summary

When a contractor segment is closed, the CAS 413.50(c)(12) adjustment must include assets associated with both active and inactive employees regardless of the pension accounting methodology adopted by the contractor, i.e., composite accounting, segment accounting covering both active and inactive employees together, or a hybrid method where segment accounting is used for active employees only and composite accounting is used for inactive employees. Auditors should verify that the contractor has properly included all assets and liabilities of the sold segment, including those related to the inactive participants, in the calculation of the segment closing adjustment.

Background

The Government won a partial summary judgment issued on May 27, 2004 by Judge Firestone of the U.S. Court of Federal Claims in the ongoing GE pension litigation. The issue addressed in the decision for the Government is whether the pension surplus associated with retiree liabilities retained by GE had to be included in the calculation of the Government share of the segment closing adjustment. GE argued that, although it accounts for its pension costs using composite accounting, CAS 413.50(c)(9) allows for the creation, and then immediate closing, of an active-employees-only segment. CAS 413.50(c)(9) provides that contractors that separately calculate pension costs for one or more segments may calculate such costs for only active participants of the segment and establish a separate "pension segment" for all inactive participants of the pension plan. Judge Firestone agreed with the Government and stated in her decision:

While it is true that contractors have discretion in establishing segments, the definition of segment in CAS precludes a contractor from excluding employees who are associated with a segment from that segment except as provided in CAS 413.50(c)(9). Moreover, a close reading of CAS 413.50(c)(9) reveals that it does not allow a contractor to create an "Active Employees-only segment," which ignores the pension costs attributable to Inactive Employees. CAS 413.50(c)(9) allows a contractor

SUBJECT: Audit Guidance on Including Inactive Employees in the Calculation of
CAS 413.50(c)(12) Pension Segment Closing Adjustments

to account for costs assignable to “only the active participants of the segment(s)” for accounting purposes, as long as it also creates a segment to account for the Inactive Employees. 48 C.F.R. 9904.413.50(c)(9) (emphasis added). Thus, the section provides that [t]he total annual pension cost for a segment having active lives shall be the amount calculated for the segment plus an allocated portion of the pension cost calculated for the inactive participants....Accordingly, contrary to GE’s reading of CAS 413.50(c)(9), contractors using an Active Employees-only segment approach must still account for pension costs allocable to Inactive Employees on an annual basis. Indeed, this requirement was included in CAS 413.50(c)(9) “to achieve comparability” with those contractors using composite accounting.

In view of the foregoing, it is clear that regardless of which of the three types of pension accounting methodologies that is selected by the contractor, the final accounting will be the same for each following a segment closing under CAS 413.50(c)(12). CAS 413.50(c)(12) provides that if the contractor has been using segment accounting on a segment-by-segment basis or pursuant to CAS 413.50(c)(9), then the calculation will be based on the pension contributions made for that segment. If, however, the contractor has used the composite method, as GE did in this case, then CAS 413.50(c)(12) requires that the contractor undertake a segment accounting exercise to determine the pension costs attributable to the segment that is being closed pursuant to CAS 413.50(c)(5). Section 413.50(c)(5) of the CAS, in turn, requires that the contractor account for all of the funds contributed by or on behalf of the segment. This necessarily includes assets associated with both Active Employees and Inactive Employees. Nothing in CAS 413.50(c)(5) suggests that a contractor may create an Active Employees-only segment and ignore the funds contributed to or on behalf of the segment for Inactive Employees.

Guidance

CAS 413.50(c)(12) requires that, when a segment is closed or sold, the contractor determine the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment. The difference represents an adjustment to previously determined pension costs. As confirmed by the recent decision in the GE pension case, regardless of the pension accounting methodology adopted by the contractor, the CAS 413.50(c)(12) adjustment must include assets and liabilities associated with both active and inactive employees for the segment. The court identified three general methodologies that contractors may elect to account for pension costs, i.e., composite accounting, segment accounting for active and inactive employees together, or a hybrid method where the contractor calculates pension cost for a segment’s active employees only and allocates pension costs for

SUBJECT: Audit Guidance on Including Inactive Employees in the Calculation of
CAS 413.50(c)(12) Pension Segment Closing Adjustments

inactive employees to the segment from a separate “pension segment” established for all inactive employees of the pension plan.

Auditors should verify that the contractor has properly included all assets and liabilities of the closed or sold segment, including those related to the inactive participants, in the calculation of the segment closing adjustment.

- ✓ The contractor may use segment accounting and calculate pension cost for all pension plan participants of the closed or sold segment, i.e., calculate pension cost for the closed or sold segment’s active and inactive pension plan participants together. In such cases, the assets reflected in the pension plan records that the contractor is required to maintain per CAS 413.50(c)(7), if properly maintained, will include all assets of the closed or sold segment.
- ✓ The contractor may calculate pension costs for only active pension plan participants of the closed or sold segment and maintain a separate pension segment for all inactive participants of the pension plan pursuant to CAS 413.50(c)(9). In such cases, an allocable portion of the assets and liabilities of the inactive pension segment must be identified with the closed or sold segment.
- ✓ The contractor may compute a composite pension cost for plan participants of the closed or sold segment and one or more other segments. In such cases, CAS 413.50(c)(12)(ii) requires an allocation of a share of the undivided market value of the assets of the pension plan to the closed or sold segment using the requirements in CAS 413.50(c)(5). The allocation of the market value of assets in accordance with CAS 413.50(c)(5) must include assets associated with both active and inactive plan participants.

Concluding Remarks

If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact Accounting and Cost Principles Division, at (703) 767-3250.

/Signed/

Robert DiMucci
Assistant Director
Policy and Plans

DISTRIBUTION: C