One of the most important lessons that can be learned from marriage is to never say, “I told you so.” Being right is rarely a goal worth reaching; most times the long-term cost to the relationship isn’t worth the momentary warm glow that accompanies the phrase “*Neener, neener. I was right and you were wrong.*”

But this is a blog, baby. Different situation; different rules. So here it is:

*We told you so.*

We **told you** that the **recent revisions** to CAS 412 and 413 necessitated by the Pension Protection Act were going to be an unpleasant surprise to many. But *not to you* **—** right? As a reader of the Apogee Consulting, Inc. blog, you not only knew that this issue was going to surface like a bubble of smelly methane gas in the swamp of arcane government contract cost accounting rules, but you also knew that DOD was *well aware* of the coming *scheiß sturm* for a least the past six years—and *did nothing*.

And now the *scheiße* has hit the fan, so to speak, as recently published polemics demonstrate. To wit—

The Citizens Against Government Waste (CAGW) is (according to Wikipedia) “functions as a think tank, ‘government watchdog’ and advocacy group for conservative fiscally causes.” (Here’s a link to **their website**.) If you want a hint as to their approach to campaigning against government waste, note that the organization’s phone number is **1-800-BE-ANGRY**.

CAGW recently issued a report on contractor pensions and post-retirement benefits (PRBs) that seemed intended to incite Congress to *DO SOMETHING* about the price being paid by taxpayers for those particular items of cost. Here’s a link to the **CAGW report** in question.

The Federal Times ran a story about the CAGW report. Here’s **a link** to the Federal Times article. The article reported that—

Taxpayers contributed more than $3.3 billion to the pension programs of 18 of the biggest federal contractors in 2010, according to estimates by the Citizens Against Government Waste (CAGW) watchdog group. …

The CAGW estimates the government reimbursed Lockheed Martin Corp., the largest federal contractor, $988 million in 2010 for its pension payments. The figure for Raytheon was $667 million, and for Northrop Grumman Corp., $529 million.

CAGW's methodology consists of extrapolating from two GAO reports concerning estimates of pension and PRB liabilities associated with Department of Energy (DOE) contractors. Note that the operative word in the Federal Times quote is "estimate". One might also reasonably wonder whether DOE's pension/PRB liabilities—which include personnel costs associated with several National Laboratories such as Los Alamos, Sandia, and Lawrence Livermore (whose Operation & Management contracts have only recently been subject to competition)—would be a good representation of the liabilities of other Departments such as Defense. But that's not the issue that we think readers should take with the CAGW report. No, the disputable issue is that CAGW has taken a position *against* reimbursement of defense contractor pension and PRB costs.

The Federal Times article quoted the CAGW report as follows—

This [reimbursement of contractor pension/PRB costs] can lead to moral hazard and higher federal spending, making it a challenge for all government agencies to meet their core mission and responsibilities, while at the same time using taxpayer money to subsidize investment decisions made by some of the most profitable corporations in the United States.

The Federal Times article reported that the CAGW report recommended several changes to the current government contract accounting policies affecting how contractors measure, propose, and bill for such costs. The article reported that CAGW "urged" the Federal government to—

- Require that its reimbursements to contractors' pension plans be based on actuarial assumptions required under federal law, not the contractors' own assumptions.

- Require that market losses in invested pension funds be recouped from the contracting companies that make the investment decisions, instead of taxpayers.

-

Stop reimbursing contractors for defined-benefit pension plans for new employees and instead reimburse them only for defined contribution plans, such as a 401(k) plan.

**This article** in Washington Technology took a different approach to the CAGW report. It told its readers—

The federal government is on the hook for billions of dollars in federal contractor private pension costs that possibly could have been avoided … Citizens Against Government Waste (CAGW) said … it has begun investigating situations in which the federal government has assumed ongoing responsibility for the cost of contractor pension plans. These situations have occurred primarily because of terms approved under cost-plus federal contracts, in which the government contributes to ongoing costs of contractor retirement benefits. …

'Many of these companies sponsor defined benefit pension plans for their employees (in which) company officials control not only the level of benefits offered, but also the strategies used for investing plan assets,' CAGW said …. 'Since many cost-plus federal contracts include clauses that ensure these pension plans are fully funded even if the plans' investment benchmarks are not met, taxpayers ultimately bear the investment risks associated with pension fund investment decisions made by some of the most profitable corporations in the United States.'

The article reported that CAGW stated that, "the structure of those contracts has encouraged several major federal contractors to maintain more expensive defined-benefits plans, even as most of government and private industry have moved away from those types of plans."

We did, in fact, review the CAGW report. Here are some salient portions of that report—

Many of these [government contractors] sponsor defined benefit plans for their employees and they control not only the level of benefits offered, but also the strategies used for investing plan assets. Since cost-plus contracts include clauses that ensure these pension plans are fully funded even if their investment assumptions are not met, taxpayers ultimately bear the investment risk. …

Federal agencies have increased pension reimbursements to contractors in order to meet the PPA requirement that private company defined benefit pensions be funded to 100 percent of liabilities. … As a result, contractors often decide to contribute more than the minimum to prevent losing favorable tax treatment or to build credit balances that can be used in the out years to try to level the amount it budgets for pension contributions. Combine the PPA standards and internal agency policies with external factors, and the result is record contractor reimbursement costs. …

While the vast majority of corporations and private businesses have transitioned to defined contribution pension plans, defined benefit plans continue to be a mainstay for many of the largest federal government contractors. They are reaping billions of dollars in reimbursements because of contractual obligations, PPA funding, actuarial requirements, and economic and financial factors. …

On December 7, 2011, Senate Armed Services Committee Chairman Carl Levin (D-Mich.) and Ranking Member John McCain (R-Ariz.) sent a letter to the GAO asking the agency to examine the cost of post-retirement benefit reimbursement at the Department of Defense (DOD). Their letter requested ‘an estimate of how much DOD has paid its contractors to backfill their pension plan shortfalls over the past 10 or so years,’ a ‘projection of future liabilities,’ an evaluation of ‘options for limiting DOD’s liability for contractor pensions, including but not limited to the options of eliminating reimbursement for all or some defined plans,’ and the savings that could be achieved from implementing the various options. It is anticipated that GAO will merge the senators’ concerns with an earlier request on the same subject matter from two other members of the Senate Armed Services Committee, and release the final report later this year.

So the CAGW report is getting play and Congress is concerned. We want to share one more article on this topic with you. It’s a **Federal Times story** from February 27, 2012.

The Federal Times story includes quotes from DOD Comptroller Robert Hale. It reported—

The Defense Department has not yet budgeted for the additional pension costs, but estimates they ‘could be billions of dollars, conceivably,’ Defense Department Comptroller Robert Hale told ‘This Week In Defense News’ on Feb. 23.

‘I'm hoping that our vendors realize in tight fiscal times that they need to work with us to hold down weapons costs,’ Hale said. ‘We think there may be modest added cost, we'll just have to see, but we are going to have to start budgeting for them, and it is a question I'm asking internally as we look into our next budget plan.’

The cost to the Pentagon will depend on how the companies' pension funds fare in the stock market, Hale said. If investments do well and earn money, a greater part of the plans will be funded, he said.

However, if investments do poorly and pension funds become further underfunded, affected contractors would be forced to make greater payments to cover those liabilities, pension experts said. And that will mean more cost to the Pentagon.

The Federal Times story also reported—

With its roots in a 2006 law, the rule's impact should have been anticipated, giving Defense Department officials plenty of time to budget for the expected costs, said David Berteau, director of the Center for Strategic and International Studies Defense-Industrial Initiatives Group.

'How can this have snuck up on us and caught us unaware?' he said. 'I didn't hear any alarm bells.' …

The impact of the new rule on government contracting costs could be dramatic given the tight budget environment most Defense Department agencies are operating under, Berteau said.

'This is way more than a bookkeeping question,' he said.

Because you read this blog, you know that we've been ringing the alarm bells for years. More importantly, you also know that DOD Leadership has known about this issue since the passage of the PPA in 2006. They knew, and they did nothing. In fact, DOD Leadership **issued direction** that prohibited anything from being done. They hid their heads in the sand. They kicked the can down the street and made it somebody else's problem to deal with. Pick your metaphor.

You knew it, because we told you so.