

## Pension Benefit Curtailment and The Aftermath

Written by Nick Sanders

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CAS 412 and 413, both gifts that keep on giving job security to actuaries, accountants, attorneys, and administrative law judges.

Which is to say, they are both complex Standards with a myriad of potential non-compliance pitfalls—especially for those few contractors that continue to maintain defined benefit pension plans. In addition—as we are about to discuss—a decision by a contractor to terminate or curtail its defined benefit pension plan can carry its own risks.

Let's start with the basics.

As many contractors do, Northrop Grumman maintained additional benefits for its senior executives. In this case, the company maintained an Officers' Supplemental Executive Retirement Plan (OSERP), which was a Rabbi trust where funds were put away for these executives, invested on their behalf, and then was made available (upon retirement) for those executives to supplement their other retirement pay and other retirement investments.

We like the old joke about such things: *When executives tell employees that people are their most important resource, that's a lie. In reality, their supplemental retirement plan benefits are their most important resource.*

Okay. We'll work on that one.

Anyway, Northrop curtailed the OSERP in 2014, after about 11 years of activity. The verb "curtailed" (or alternatively "froze") was explained as "ending further contributions to the plan and curtailing increased benefits based on such contributions. Persons entitled to the pension would still receive it upon retirement, but their payments would be based upon their years of service as of the date of the curtailment, rather than their years of services as of their retirement date."

As CAS 413 requires, when Northrop decided to curtail its plan, it calculated the plan's assets

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and liabilities. If the assets are greater than the present value of the obligations, it means the government “overpaid” the pension plan expenses in prior years and is entitled to a refund. But if the assets of the pension plan are calculated as less than the present value of its obligations, then the contractor is entitled to a proportionate payment from the government to remedy the situation, because the prior years’ expenses were too low.

Here, Northrop did the actuarial math and calculated that the government owed it \$75.7 million. Unsurprisingly, the government objected to both Northrop’s math and the resulting value. According to the government, when it did its own math and adjusted for Northrop’s inappropriate adjustments, it still owed the contractor some money—about \$28.1 million—but nowhere in the neighborhood of \$76 million. And that difference of \$47.6 million became the amount of a claim and then a dispute, to be [decided](#) by the ASBCA.

Say what you want about the Cost Accounting Standards, but they certainly can generate some large-dollar controversies.

The funny thing—as noted by Judge Prouty—the Contracting Officer (or CFAO, as this function is called in the world of CAS) rejected Northrop’s claim in full, even though she agreed the government owed \$28.1 million. Why? Because she said “she did not have the authority to pay this money.” That’s quite a puzzling statement and Judge Prouty noted “In our memory, we have never encountered a CO denying, in full, a claim that she determined to be partially owed to a contractor on the grounds of lack of authority. It is potentially problematic, to say the least ....” Of course, she had the authority and a failure to compensate Northrop for the amount she agreed was owed to the company teetered on being arbitrary, capricious, and/or an abuse of discretion. What does a Certificate of Appointment mean? Who’s training these government folks?

So there were pages and pages of discussion about mortality tables and the appropriate use of interest expense deductions when calculating the final settling-up amount. One issue was that CAS 412-50(a)(5) explicitly states that tax liability may not be used to recalculate rates of return even as it allows taxes as an expense. However, Judge Prouty noted that the pension settlement calculation was being made pursuant to the requirements of CAS 413—and CAS 413 did not contain an equivalent prohibition. Judge Prouty found that Northrop’s treatment of income tax payments on the OSERP assets was not compliant with CAS 412, but that it did not constitute a material noncompliance because “consideration of taxes as an expense was permissible and leads to the same result.”

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Readers may recall that CAS does not deal with immaterial costs. You cannot be in non-compliance with CAS if the calculated value of the non-compliance is immaterial. As Judge Prouty correctly summed-up: "... we conclude that considering taxes in estimating the OSERP's actuarial accrued liability was not CAS-compliant, but that the result here, of calculating them as a discount to the interest rate applied to the plan's investments, was not material and generated an identical result, which we need not revisit."

Having discussed and disposed of all government arguments against Northrop's calculations, Judge Prouty declared—

The appeal is sustained in whole. We understand that the government has already begun compensating NG for some of the funds that the CO acknowledged were due and owing to it. This appeal is remanded to the parties to calculate the amount currently due and owing from the government to NG.

CAS 412 and 413, both complex Standards that have generated a more-than-fair-share number of disputes with respect to defined benefit pension plans. If you are not subject to Full CAS coverage or do not have a defined benefit pension plan, be thankful.