If our recent **pension accounting discussion** didn't thrill you, it's not likely that this article is going to float your boat either. Two recent decisions by the U.S. Court of Federal Claims (Co FC), both issued by Judge Firestone on April 29, 2010, appear to conclude that there is no Cost Accounting Standard that covers accounting for post-retirement benefits other than pensions (PRBs).

"What's a PRB?" you may well be asking. A PRB is a non-cash benefit (other than a pension distribution) that is provided to employees after retirement. Typically, PRBs include life and medical insurance. But some PRB plans include legal services, and even tuition credits. PRBs may be fully funded by a company, or partially funded (with employees sharing the rest

of the costs). For GAAP purposes, companies need to account for PRB liabilities in accordance with
SFAS 106
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Readers might notice that SFAS 106 was promulgated in 1990, far after the original CAS Board had finished promulgating Cost Accounting Standards.

The link above will allow you to review the SFAS 106 summary and learn about its requirements. For purposes of this article, suffice to say the Statement requires that an employer's obligation for PRBs expected to be provided to an employee "must be fully accrued by the date that the employee attains full eligibility" for the benefits.

Importantly, the FAS Board expressly acknowledged that the provisions of SFAS were similar to provisions in Financial Accounting Statements governing accounting for pensions (i.e., SFAS Nos. 87 and 88). In the words of the FAS Board, "to the extent the promise to provide pension benefits and the promise to provide postretirement benefits are similar, the provisions of this Statement [SFAS 106] are similar to those prescribed by Statements 87 and 88; different accounting treatment is prescribed only when … there is a compelling reason for different treatment." Keep the FAS Board's linkage of the accounting for pensions and PRBs in mind as we take a look at Judge Firestone's decisions.

Raytheon Company v. The United States

The complete decision can be found **here**. Raytheon was required to calculate a segment-closing pension adjustment in accordance with CAS 413-50(c)(12). The company wanted to include its PRB liabilities in that pension calculation.

Judge Firestone reviewed the history of ERISA and CAS, before opining on Raytheon's PRB plans. In particular, she quoted the CAS Board's preamble to CAS 416—

The [CASB] believes that these standards provide ample criteria for determining which standard is applicable to any given cost. In particular, the question of whether a benefit, such as insurance provided to retired persons, is an integral part of a pension plan and thereby governed by CAS . . . 412 or is a part of an insurance program and therefore governed by CAS 416 is a question of fact in each given instance. Moreover, application of either standard to this element would result in substantially the same amounts of allocable costs.

Judge Firestone also reviewed SFAS 106 and the proposed Standard 419 (which would have expressly covered PRBs), as well as the history of FAR 31.205-6(o)—which discusses the allowability of PRB costs. (“ … To be allowable, PRB costs must be reasonable and incurred pursuant to law, employer-employee
agreement, or an established policy of the contractor. In addition, to be allowable in the current year, PRB costs must be paid …”)

Finally, Judge Firestone concluded that Raytheon’s PRB plans were not “pension plans” as that term is defined in CAS. She wrote, “… health benefits or medical benefits, which clearly do not vest and are terminable at will, are not ‘integral’ to a pension plan.” Raytheon’s PRB costs were not pension costs and could not be included in its CAS 413 pension calculations.
In forming her decision, the Judge relied heavily on the CAS Board’s published decision not to issue Standard 419. She wrote—

The court is mindful of established rules of administrative law which provide that proposed regulations have no legal effect and are not entitled to deference. The court is also mindful of established rules of construction that caution against relying on the views of a legislature to interpret the meaning of a law written by a previous legislature. However, there are situations where policy pronouncements are entitled to appropriate deference based on the context of the pronouncement. The court finds that this is one of those circumstances. (Citations omitted.)

Judge Firestone gave the "highest degree of deference" to the FAR Councils' comments when publishing FAR 31.205-6(o). The rule requires that the government is entitled to an equitable share of any previously funded PRB costs that "revert or inure" to the contractor if it decides to terminate or reduce PRB benefits. However, the door only swings one way: unlike pension plans, if a segment is closed with unfunded PRB liabilities remaining, the contractor is *not* entitled to a segment-closing PRB adjustment.

But Judge Firestone did offer Raytheon (and other contractors) a ray of hope. She wrote—

The fact that Raytheon's PRB costs are not included in the CAS 413.50(c)(12) segment closing adjustment does not mean that Raytheon will not be able to recover its PRB costs from the government following these segment closings. To the extent Raytheon continues to fund its PRBs, it will be able to allocate its PRB costs across all of its remaining segments under CAS 403.40(c), 48 C.F.R. § 9904.403-40(c) (2010). The government has agreed to allow contractors that continue to generate PRB costs to allocate those costs to the government as residual costs under other contracts following a segment closing.

General Electric Company v. The United States

In her next **decision** , Judge Firestone discussed GE's "pay-as-you-go" (PAYG) PRB plans in related to its segment-closing calculations. In PAYG plans, costs are recognized for government contract cost accounting purposes only when they are actually paid to employees (or retired employees).

We were interested to note that Judge Firestone entertained the testimony of "experts" to help her understand the interplay of the various regulatory requirements (which she discussed at length in the Raytheon decision).
She said, "Due to the complexity of the interrelationship of the various CAS and FAR provisions to the measurement, allocation and payment of PRB costs, the court found it beneficial to hold a hearing of experts to explain how these provisions are applied in practice."

Given her decision in Raytheon (discussed at length above), it is hardly surprising that the Judge found against GE, deciding that its PRB costs could not be included in its segment-closing pension

adjustment calculations. She noted that "… the reason that CAS 413.50(c)(12) does not extend to GE's PAYG PRB costs is that CAS 413 provides a means to sort out actuarial gains and losses and does not extend to situations where no such actuarial gains and losses were ever allocated to government contracts. Actuarial gains and losses only arise in the context of accrual accounting."
Moreover, she wrote—

Pension plans funded using PAYG accounting that do not have compellable benefits have not been allocated to contracts based on actuarial determinations. Accordingly, these non-compellable PAYG costs have not been allocated to government contracts based on actuarial assumptions, assumptions that, while meant to be as accurate as possible, inevitably result in over or under payments. Because non-compellable PAYG costs have been allocated to government contracts based only on the actual payments made to retirees, no assumptions were used and no costs based on actuarial gains or losses were allocated to government contracts. In such circumstances, there are no 'previously determined costs' that need to be adjusted in a CAS 413 segment closing adjustment.

Judge Firestone ran through several of the Standards, noting how each did not cover PRBs—at least as GE had decided to account for them. She also

dispensed with GE's argument that, by virtue of the segment closing, the government had received an illegal "windfall" that could only be corrected by permitting GE to reduce its otherwise payable segment-closing pension adjustment.

To sum up, Judge Firestone concluded that the Federal cost accounting rules that cover pension plans do not extend to PRB plans, at least with respect to the Raytheon and General Electric Companies. The only regulatory coverage is to be found in the FAR, whose provisions are relatively strict (at least from a contractor's point of view).

It may seem forever to you by now, but remember back at the beginning of this article, when we noted that the FAS Board expressly called-out similarities between pension and PRB accounting? Accountants may think that the similarities compel similar treatment—but Judge Firestone was not persuaded.