September 22, 2006

Financial Management

Consolidation of Northrop Grumman Pension Accounting Records for the Acquisition of TRW (D2006-113)

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Acronyms

BSC	Business Support Center
CAS	Cost Accounting Standards
CIPR	Contractor Insurance/Pension Review
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DoD IG	Department of Defense Inspector General
SEG	Space and Electronics Group
SIG	Systems Integration Group

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

September 22,2006

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

SUBJECT: Report on Consolidation of Northrop Grumman Pension Accounting Records for the Acquisition of TRW (Report No. D-2006-113)

We are providing this report for your review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Contract Management Agency comments were not responsive. We request the Director, Defense Contract Management Agency to provide additional comments on Recommendations 1., 2.a. and 2.b. by October 23,2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audclev@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Raymond D. Kidd at (703) 325-5515 or Mr. Kenneth B. VanHove at (216) 706-0074 extension 245. See Appendix B for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

Paul J. Granetto

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Department of Defense Office of Inspector General

Report No. D-2006-113 **September 22, 2006**
(Project No. D2006-D000FC-0001.000)

Consolidation of Northrop Grumman Pension Accounting Records for the Acquisition of TRW

Executive Summary

Who Should Read This Report and Why? DoD and private sector contracting, accounting, and auditing officials who deal with Defense contractor business combinations, divestitures, and pensions should be interested in this report for its application in accounting for Government-funded pension assets following a merger.

Background. Northrop Grumman is among the largest companies in the defense industry. Northrop Grumman conducts most of its business with the U.S. Government, which accounted for approximately 87 percent of Northrop Grumman's total revenues in 2004. Historically, Northrop Grumman concentrated its efforts in high technology areas such as stealth, airborne surveillance, precision weapons, systems integration, and defense electronics. Northrop Grumman has continued to expand its presence in these areas through various acquisitions, to include the acquisition of TRW.

On December 11, 2002, Northrop Grumman issued 139 million shares of stock in exchange for all outstanding shares of TRW. TRW was a U.S.-based international company, which operated its business under three divisions: Automotive, Systems, and Space and Electronics. At the time of acquisition, approximately 30 percent of TRW total sales were to the U.S. Government. After Northrop Grumman acquired the TRW stock, Northrop Grumman sold the TRW Automotive Division and retained the Systems and Space and Electronics divisions performing Government-related work.

Defense contractors charge DoD for costs associated with each pension plan having participants who perform Government work. These pension costs charged to Government contracts are not paid as benefits during the performance of the contract. Rather, the pension costs are accumulated as Government-funded assets in a pension trust for future payment of benefits when the employees retire. Once DoD is charged for and pays pension costs for a business segment with Government contracts, these contributions are accounted for as assets of the segment. If a business segment is sold, the parties may agree to a continuation of the pension plan with the buyer and a corresponding transfer of the Government-funded pension assets and liabilities to the successor contractor. If the pension plan is retained by the seller, a settlement is negotiated with the Government as an adjustment to the previously paid pension costs.

Results. Defense Contract Management Agency representatives did not document why a 21 percent increase in pension costs occurred for the TRW Salaried Pension Plan immediately following the Northrop Grumman acquisition of TRW. As a result, DoD has no assurance that the increased costs to the TRW Pension Plan at the time of the Northrop Grumman acquisition are reasonable. The Director of the Defense Contract Management Agency should require a Contractor Insurance/Pension Review (CIPR) of the pension-related events that occurred at the time of the Northrop Grumman acquisition of TRW. The Director of the Defense Contract Management Agency should also update existing CIPR guidance in the Defense Contract Management Agency guidebook to require CIPR teams to maintain documentation supporting the decision not to conduct a CIPR when high-risk issues are present. Additionally, the CIPR guidance should be updated to include a change in the percentage of a contractor's Government-to -commercial workload as a high-risk event. See the Finding section of the report for detailed recommendations.

Management Comments and Audit Response. The Executive Director of Contract Operations and Customer Relations, Defense Contract Management Agency commented on the draft of this report, however, the comments are not responsive. The Executive Director disagreed that a CIPR should be performed to examine the pension-related events we identified that may have caused the 21 percent increase in pension costs. The Executive Director' comments also stated that Defense Contract Management Agency would address recommendations related to updating guidance once DoD Inspector General auditors finish their series of audits of pension plans at the major contractors. We still believe that the only way Defense Contract Management Agency can determine whether the 21 percent increase in pension costs was reasonable is to perform a CIPR specific to that purpose. We also see no reason for the Defense Contract Management Agency to wait for other audits before addressing the need for guidance as the guidance we are recommending would apply to all major contractor pension plans. We request that Defense Contract Management Agency provide comments on the final report by October 23, 2006. See the Finding section of the report for a discussion of management comments. See the Management Comments section of the report for the complete text of the Defense Contract Management Agency's comments.

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Background

Northrop Grumman Acquisition of TRW. Northrop Grumman is among the largest companies in the defense industry. Northrop Grumman conducts most of its business with the U.S. Government, which accounted for approximately 87 percent of Northrop Grumman's total revenues in 2004. Historically, Northrop Grumman concentrated its efforts in high technology areas such as stealth, airborne surveillance, precision weapons, systems integration, and defense electronics. Northrop Grumman has continued to expand its presence in these areas through various acquisitions, to include the acquisition of TRW.

On December 11, 2002, Northrop Grumman issued 139 million shares of stock in exchange for all outstanding shares of TRW. TRW was a U.S.-based international company, which operated its business under three divisions: Automotive, Systems, and Space and Electronics. At the time of acquisition, approximately 30 percent of TRW total sales were to the U.S. Government. After acquiring the TRW stock, Northrop Grumman sold the TRW Automotive Division and retained the Systems and Space and Electronics Divisions performing Government-related work.

Cost Accounting Standards. Generally, corporations that negotiate contracts of $50 million or more with the Government are required to comply with the Cost Accounting Standards (CAS). Included in the CAS are rules for pension accounting under CAS 9904.412, "Cost Accounting Standard for Composition and Measurement of Pension Cost," October 1, 2004,[1] and CAS 9904.413, "Adjustment and Allocation of Pension Cost," October 1, 2004.[1] CAS 9904.412 prescribes guidance for determining the components of pension costs, as well as measuring, assigning, and allocating pension cost. CAS 9904.413 provides guidance for assigning actuarial gains and losses, valuating the assets of a pension plan, and allocating pension cost to segments.

Pension Plan Assets. Defense contractors charge DoD for costs associated with each pension plan having participants who perform Government work. These pension costs charged to Government contracts are not paid as benefits during the performance of the contract. Rather, the pension costs are accumulated as Government-funded assets in a pension trust for future payment of benefits when the employees retire. Once DoD is charged for and pays pension costs for a business segment with Government contracts, these contributions are accounted for as assets of the segment. If a business segment is sold, the parties may agree to a continuation of the pension plan with the buyer and a corresponding transfer of the Government-funded pension assets and liabilities to the successor contractor. If the pension plan is retained by the seller, a settlement is negotiated with the Government as an adjustment to the previously paid pension costs.

Contractor Insurance/Pension Review Teams. The Defense Federal Acquisition Regulation Supplement (DFARS), Part 242, "Contract Administration," Subpart 242.73, "Contractor Insurance/Pension Review,"

[1] A review of the CAS in effect at the time of the Northrop Grumman acquisition of TRW identified no differences with the current citations that would affect the results of the review.

February 23, 2006,[2] establishes DoD requirements for conducting a Contractor Insurance/Pension Review (CIPR). DFARS establishes a joint Defense Contract Management Agency (DCMA)/Defense Contract Audit Agency (DCAA) CIPR team and identifies DCMA as the DoD Executive Agency for the performance of all CIPRs. The CIPR team is responsible for conducting comprehensive reviews that include pension plans and related policy, procedures, practices, and costs. The CIPR team performs the review at the request of the Defense Corporate Executive.[3] As the Executive Agency for CIPRs, DCMA created two CIPR Centers – CIPR Team East in Staten Island, New York, and CIPR Team West in Carson, California. The CIPR Centers' responsibility is to provide guidance and consultation to DoD contracting personnel regarding pension plan laws and regulations. Additionally, the CIPR Centers provide guidance and consultation regarding pension plan calculation methodologies for acceptable actuarial methods and the use of reasonable assumptions.

Objective

Our overall audit objective was to evaluate the DCMA reviews of Northrop Grumman consolidations of pension accounting records for selected business acquisitions to verify performance of reviews in accordance with the Federal Acquisition Regulation and DFARS. Specifically, we determined whether the DoD interest in Government-funded pension assets had been adequately protected. See Appendix A for a discussion of the scope and methodology, and prior coverage related to the objectives.

Managers' Internal Control Program Review

DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," January 4, 2006, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Managers' Internal Control Program. We did not review the entire DCMA system of internal controls. However, we did review the internal controls applicable to our audit objectives. During the course of the audit, we identified internal control weaknesses involving DCMA performance of CIPRs and DCMA CIPR guidance. See the finding for further details on the internal control weaknesses.

[2] Based on a review of the DFARS Subpart 242.73 in effect at the time of the Northrop Grumman acquisition of TRW, no significant differences with the current citations were identified that would affect the results of the review.

[3] A Defense Corporate Executive is the DoD's liaison to the contractor's corporate management assigned to DoD's largest contractors. These individuals also perform selected contract management functions having a corporate-wide impact.

Pension Plan Costs After the Northrop Grumman Acquisition of TRW

DCMA representatives did not document why a 21 percent increase in pension cost occurred for the TRW Salaried Pension Plan (the TRW Pension Plan) immediately following the Northrop Grumman acquisition of TRW. They did not document the cause of the increase because the scope of various CIPRs did not address all the pension-related events that may have caused the increased pension costs at the time of acquisition. As a result, DoD has no assurance that the increased costs to the TRW Pension Plan at the time of the Northrop Grumman acquisition are reasonable.

TRW Salaried Pension Plan

When Northrop Grumman acquired TRW, the TRW Pension Plan included 4 distinct segments with assets valued at more than $2 billion. The Systems Integration Group (SIG) and the Space and Electronics Group (SEG) segments accounted for all Government-related pension assets and liabilities. The Business Support Center (BSC) segment represented the pension assets and liabilities for the corporate personnel performing both Government and commercial work. The final segment included the pension assets and liabilities for personnel performing commercial work. After the acquisition, Northrop Grumman renamed the TRW Pension Plan the Northrop Grumman Space and Mission Systems pension plan.

DoD Pension Cost Changes

DCMA representatives did not document why pension costs increased by 21 percent for the TRW Pension Plan immediately following the Northrop Grumman acquisition of TRW. The forward pricing rate proposals for the SIG, SEG and BSC segments showed significant pension cost increases after the acquisition. The following table shows the pension cost increases for the three segments by comparing the TRW forward pricing rate proposal for the two Government and BSC segments within the TRW Pension Plan to the same segments within the Northrop Grumman forward pricing rate proposal for the Northrop Grumman Space and Mission Systems pension plan.

TRW Salaried Pension Plan Costs for 2003 (dollars in thousands)		
	SIG/SEG Costs	BSC Costs
Northrop Grumman Proposal	$140,520	$3,720
TRW Proposal	116,238	1,026
Increase	24,282	2,694
Percent Increase	**21**	**263**

The change in pension costs for the Northrop Grumman Space and Mission Systems pension plan may have occurred because of several pension-related events occurring at the time of the acquisition. These events include:

- changes to the long-term valuation rate used in the plan,
- different long-term investment rates used for forward pricing calculations,
- payment of lump sum benefits for corporate commercial employees, and
- pension costs paid by DoD for new line items included in the Government segments.

Long-Term Valuation Rate. Northrop Grumman changed the long-term valuation rate actuarial assumption for the Northrop Grumman Space and Mission Systems pension plan from 8.5 percent to 8 percent after Northrop Grumman acquired TRW. The pension plan liability increases with a corresponding decrease in the long-term valuation rate, which increases pension costs for DoD. Northrop Grumman reduced the pension plan rate because numerous TRW employees took a lump sum benefit payment upon acquisition by Northrop Grumman. These payments decreased the pension assets available to earn future interest. Northrop Grumman reduced the actuarial long-term valuation rate for a more realistic reflection of investment return. DCMA representatives indicated the change from 8.5 percent to 8.0 percent was reasonable. However, DCMA representatives did not provide documentation supporting the reason for the rate change, a review of the impact on pension costs, or a review of the impact on the valuation of pension liabilities by segment.

Forward Pricing Long-Term Investment Rate. Northrop Grumman used a long term investment rate of 8.5 percent to calculate the forward pricing rate proposal for 2003 through 2009. However, Northrop Grumman's actuary used a long-term investment rate of 8 percent. A higher interest rate for forward pricing decreases DoD's pension costs. A lower interest rate will increase pension costs for DoD. Using a higher interest rate should have resulted in a decrease in forecasted pension costs; however, as indicated in the table, forecasted pension costs for 2003 increased significantly. DCMA representatives should consider the use of different long-term investment rates in 2003 when assessing the increase in pension costs.

BSC Segment Pension Costs. DCMA representatives did not provide documentation supporting an analysis of the lump sum benefit payments made to TRW Pension Plan participants and the related impact on Government pension costs. In addition, DCMA representatives were unable to provide documentation of the number or type of employees who took the lump sum benefit payments. The BSC segment within the TRW Pension Plan represented corporate headquarters employees performing both commercial and Government work. In 2002, DoD was charged 33 percent of the pension costs for the BSC. At the time of the Northrop Grumman acquisition, corporate employees may have received a lump sum benefit payment offered by the TRW Pension Plan. After the sale of the TRW commercial segment, DoD paid a higher percentage of pension costs for BSC employees based on the increased ratio of Government to commercial work. Although this seems reasonable, DoD may be paying increased pension costs for lump sum benefit payments made to corporate employees who performed commercial work. DCMA representatives stated that identifying specific pension costs as commercial and unallowable is not simple and may be insignificant. However, DCMA representatives were unable to provide analysis supporting their opinion.

New Line Items. DCMA representatives did not provide documentation supporting analysis of the allowability of new line item pension costs charged to Government pension segments. In 2003, DoD paid pension costs for new line items in the Northrop Grumman Space and Mission Systems pension plan not identified prior to the Northrop Grumman acquisition of TRW. DoD paid an additional $55 million and $133 million for 2003 and 2004, respectively, for the new line items. For example, in 2003, DoD paid $1.5 million in pension costs for the "GIT Commercial Public Admin and Human Services-SIG" line item. The DCMA pension specialist was unaware of the new line items and the associated pension costs, even though some of the new line items appeared to be commercial in nature. Although DCMA representatives stated that they typically don't review the pension costs at the detail level, they said these costs were allowable. However, DCMA representatives were unable to provide documentation of this analysis.

CIPR Reports

Although DCMA representatives conducted several CIPRs, the scope of the CIPRs did not address all the pension-related events that may have caused the increased pension costs at the time of acquisition. According to DFARS, the acquisition of TRW and the 21 percent increase in pension costs should have prompted DCMA representatives to conduct a CIPR including these pension-related events. Additionally, these events met the criteria provided as high-risk in DCMA guidance. As a high-risk area, the pension-related events should be included as part of a CIPR. A CIPR addressing these pension-related events should have identified the reasonableness of increased pension costs.

CIPRs. DCMA representatives performed several CIPRs on Northrop Grumman after the acquisition of TRW. DCMA Report No. 083-05, August 31, 2005, "Special CIPR NGC [Northrop Grumman Corporation]," reviewed the 2002 (and 2003, if available) actuarial valuations for 22 qualified retirement plans and various non-qualified plans. DCMA Report No. 068-04, May 28, 2004, "Special CIPR NGC [Northrop Grumman Corporation]," examined pension plan costs forecasted for 2004, including the TRW Pension Plan. DCAA audit report No. 4721-2004F19413001, "Review of Pension Segment Closing Requirements Associated with the Divestiture of TRW Automotive and Aeronautical Systems Group," August 10, 2005, reviewed Northrop Grumman's divestitures of TRW commercial divisions for compliance with CAS. However, the scope of these CIPRs did not address the specific pension-related events identified in this report.

DFARS. DFARS Subpart 242.73 provides the requirements for conducting a CIPR. The regulation specifies that a special CIPR should be performed if the contractor is involved in a merger, acquisition, or divestiture. A CIPR needs to be performed when there is a material impact on Government contract costs. The Northrop Grumman acquisition of TRW represented an acquisition. The 21 percent increase in pension costs had a material impact on DoD costs. Therefore, the DCMA representatives should have conducted a CIPR that addressed the specific pension-related events identified in this report.

DCMA Guidebook. According to the DCMA Guidebook, "Contractor Insurance and Pension Review," October 2004, the CIPR process is based on risk management. The scope of the CIPR is based on those specific aspects of a contractor's pension program that represent a high-risk. Examples of high-risk areas include the following situations.

- A forward pricing proposal has been submitted which includes a defined benefit pension plan.

- The qualifying sales of a new or existing contractor reach the $40 million threshold.

The Northrop Grumman acquisition of TRW included both of these high-risk elements. The DCMA pension specialist stated that, although most mergers and acquisitions are considered high risk, a CIPR was not necessary in this instance. However, the DCMA pension specialist did not document the recommendation for not conducting a CIPR covering the pension-related events.

Additionally, the DCMA pension specialist did not consider the effect of a change in the percentage of Government work when determining whether to conduct a CIPR. However, when Northrop Grumman sold the commercial segments, costs associated with employees who performed primarily commercial work may become costs to DoD as the percentage of workload transitions. These pension costs should be reviewed and considered as high-risk.

Conclusion

DCMA representatives did not document why the Northrop Grumman pension costs increased by 21 percent. Therefore, DoD has no assurance that the increased costs to the TRW Pension Plan at the time of the TRW acquisition are reasonable. Several pension-related events at the time of the acquisition may have contributed to the change in pension costs, including the change in the long-term interest valuation rate, the use of a different long-term investment rate for forward pricing calculations, the payment of lump sum benefits associated with corporate commercial employees, and the new pension line item costs charged to DoD. However, since a CIPR was not conducted to review these pension-related events, DCMA representatives cannot determine the reasonableness of the Space and Mission Systems pension plan costs. Therefore, DCMA representatives should conduct a CIPR that covers the pension-related events discussed in this report to determine why the pension plan costs increased by 21 percent. Without conducting this review, DoD may continue to pay higher pension costs without knowing whether the increase in pension costs for the Northrop Grumman Space and Mission Systems pension plan are reasonable.

Management Comments on the Finding and Audit Response

DCMA Comments. DCMA disagreed that a CIPR should be performed to examine the pension related events we identified that may have caused the 21 percent increase in pension costs. DCMA indicated that the CIPRs performed for Northrop Grumman focused on the transfer of pension assets during the sale of TRW to Northrop Grumman, which represents the most high risk aspect of any sale or merger. DCMA also stated that the pension related events identified by the DoD IG were not shown to be associated with any unallowable pension cost. In addition, the CIPRs performed did not disclose any unallowable pension costs. DCMA indicated that the CIPRs performed for Northrop Grumman included the information needed by the Defense Corporate Executive. DCMA stated performing another CIPR would not provide any value added benefit to the Defense Corporate Executive.

Audit Response. We agree that the Defense Corporate Executive had several CIPR reports on which to base decisions. However, the reasons for the 21 percent increase in pension costs immediately following the acquisition of TRW by Northrop Grumman have not been identified and documented. The DCMA comments do not provide any definitive reasons for the significant increase in the pension costs. Additionally, the CIPRs performed do not address why this significant pension cost increase occurred at the time of the acquisition. Without identifying the reasons for this significant increase, the reasonableness of these pension costs cannot be determined. The finding indicates several pension related events that may have resulted in an increase in pension costs. The cost of these events has not been quantified to identify the percentage of cost increase related to any specific pension event. We maintain that the reasons for such a significant increase in pension costs to DoD should be specifically identified and documented.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Contract Management Agency:

1. Require a Contractor Insurance/Pension Review of the pension-related events that occurred at the time of the Northrop Grumman acquisition of TRW.

DCMA Comments. DCMA nonconcurred because in accordance with the DFARS guidance and the DCMA guidebook, the Defense Corporate Executive is responsible for determining the scope of the CIPRs performed at the time of mergers. The CIPRs performed by DCMA in 2004 provided the necessary information in order for the Defense Corporate Executive to make prudent decisions pertaining to the contractor's pension accounting and associated costs. In addition, DCMA stated that the Defense Corporate Executive had all necessary information needed to make decisions and determine the reasonableness of pension cost related to the acquired pension plans. Further, a comprehensive CIPR of the pension related events identified in this report would be of no value to the Defense Corporate Executive.

Audit Response. The DCMA comments are not responsive to the recommendation. The primary reason for the recommendation is to identify the reasonableness of the 21 percent pension cost increase. The DCMA response does not indicate the specific events that caused the increased pension costs. Additionally, the CIPRs performed do not address why this significant pension cost increase occurred at the time of the acquisition. DCMA does not quantify the percentage of cost increase related to any specific pension event at the time of the acquisition of TRW. The Defense Corporate Executive cannot determine that a 21 percent increase is reasonable without identifying and documenting the reasons it occurred. A CIPR should be conducted to determine the reasons for the increase and to identify the reasonableness of any factors that contributed to increased pension costs. We request that DCMA reconsider its position on the recommendation and provide comments on the final report.

2. Update existing Contractor Insurance/Pension Review guidance in the Defense Contract Management Agency guidebook as follows.

a. Require CIPR teams to maintain documentation supporting the decision not to conduct a Contractor Insurance/Pension Review when high-risk issues are present but a Contractor Insurance/Pension Review is not conducted.

DCMA Comments. DCMA nonconcurred stating that guidance related recommendations would be addressed at the completion of the DoD IG's series of audits of pension plans at the major contractors. DCMA indicated that in this manner, changes to guidance can be addressed on a comprehensive basis which would avoid developing guidance related to contractor-specific situations or circumstances.

Audit Response. The DCMA comments are not responsive to the recommendation. We do not agree that maintaining documentation supporting the decision not to conduct a CIPR when high risk issues are present is a contractor-specific situation. The documentation would indicate the Defense Corporate Executive's rationale for not conducting a CIPR regardless of the contractor involved. We request that DCMA reconsider its position on the recommendation and provide comments on the final report.

b. Include a change in the percentage of a contractor's Government-to-commercial workload as a high-risk event.

DCMA Comments. The DCMA nonconcurred stating that guidance related recommendations would be addressed at the completion of the DoD IG's series of audits of pension plans at the major contractors. DCMA indicated that in this manner, changes to guidance can be addressed on a comprehensive basis which would avoid developing guidance related to contractor-specific situations or circumstances.

Audit Response. The DCMA comments are not responsive to the recommendation. We do not agree that identifying a change in a contractor's government to commercial workload as a high risk event is a contractor-specific situation. This type of change in workload can occur regardless of the contractor involved. We request that DCMA reconsider its position on the recommendation and provide comments on the final report.

Management Comments Required

In response to the final report, management is requested to provide additional comments on recommendations 1., 2.a. and 2.b.

Appendix A. Scope and Methodology

To evaluate the DCMA reviews of the Northrop Grumman pension accounting records and determine whether DoD's interest in Government-funded pension assets was adequately protected, we reviewed pension asset records, applicable DCMA and DCAA reports, and actuarial reports for both Northrop Grumman and TRW. Specifically, we met with representatives from Headquarters, DCMA; DCMA Staten Island, New York (CIPR Team East); DCMA Carson, California (CIPR Team West); DCMA Resident Office at Northrop Grumman; DCMA Cleveland, Ohio; Headquarters, DCAA; DCAA, Northern Ohio Branch Office; DCAA Northrop Grumman Corporation Resident Office; and Northrop Grumman. We reviewed documentation dated November 17, 1992, through August 10, 2005. We performed this audit from September 2005 through April 2006 in accordance with generally accepted government auditing standards. The scope of our audit was limited to the Northrop Grumman acquisition of TRW. Our review did not identify any instance where Government-funded pension assets were not adequately protected. Also, we did not review the managers' internal control program because it was not a stated audit objective.

To accomplish the audit objectives, we reviewed the following.

- Pension segment accounting records prepared by Northrop Grumman and TRW, the Internal Revenue Service Form 5500 as submitted to the Department of Labor for 1995 - 2003, Actuarial Reports for 1997 and 1999 - 2003, trust statements for 2003 for the Northrop Grumman Space and Mission Systems pension plan, and 1995 - 2004 financial reports for Northrop Grumman and TRW. We also reviewed purchase and sale agreements for the sale of the TRW Automotive Division and the Northrop Grumman acquisition of TRW. We reviewed the documents to determine whether the assets of the TRW Pension Plan were accounted for and transferred properly as a result of the Northrop Grumman acquisition of TRW.

- Applicable laws and regulations to include Cost Accounting Standard 412, "Cost Accounting Standard for Composition and Measurement of Pension Cost;" Cost Accounting Standard 413, "Adjustment and Allocation of Pension Cost;" DFARS Subpart 242.73, "Contractor Insurance/Pension Review;" the Defense Contract Audit Agency Contract Audit Manual; and the DCMA Instructions and Guidebook for Contractor Insurance/Pension Reviews. We reviewed the documents to evaluate whether the transaction involving the Northrop Grumman acquisition of TRW represented a segment closing and if it required a segment closing calculation. Also, we reviewed the documents to determine whether DCMA conducted CIPRs in accordance with applicable guidance.

- Northrop Grumman Space and Mission Systems pension plan forward pricing rate proposals for 2002 through 2005, DCAA audit reports for 2003 through 2005, and DCMA technical review reports for 2003 through 2005 related to the costs associated with the forward pricing rate proposals. We reviewed the documents to determine whether pension cost issues raised by DCAA had been resolved and potential reasons for increases in pension costs for the plan after the Northrop Grumman acquisition of TRW.

Use of Computer-Processed Data. We did not evaluate the general and application controls related to the contractor computer systems used to generate pension-related reports. We did not evaluate the controls because the information was used only to determine whether the proper amount of pension assets were transferred to the Government-related pension plans during the business acquisitions. Therefore, the results of the audit were not affected by not evaluating the controls.

Use of Technical Assistance. Pension experts from the Department of Defense Office of Inspector General Defense Financial Auditing Service directorate assisted the audit team on pension-related issues. Additionally, a computer engineer from the Department of Defense Office of Inspector General Investigative Policy and Oversight, Technical Assessment Division helped us determine the feasibility of creating a pension asset database.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Financial Management high-risk area.

Prior Coverage

During the last 5 years, the Department of Defense Inspector General (DoD IG) has issued three reports discussing pension assets. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports.

DoD IG

DoD IG Report No. D-2005-077, “Accounting for Sperry Marine Pension Plan Assets under an Advance Agreement with Litton Industries, Inc.,” June 17, 2005.

DoD IG Report No. D-2004-025, “Accounting for Pension Assets under Advance Agreements with Northrop Grumman and Litton Industries, Inc.,” November 25, 2003.

DoD IG Report No. D-2002-145, “Effect of Raytheon Defense Business Acquisitions on Pension Plans and DoD Funded Pension Assets,” September 11, 2002.

Appendix B. Report Distribution

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Defense Contract Management Agency Comments

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IN REPLY REFER TO DCMA-DMI

MEMORANDUM FOR PROGRAM DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE, OFFICE OF DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: DoDIG Draft Report, Project Number D2006-D000FC-0001, Report on Consolidation of Northrop Grumman Pension Accounting Records for the Acquisition of TRW

Reference: DoDIG draft audit report, Project Number D2006-D000FC-0001, subject as above.

We have attached the Headquarters, Defense Contract Management Agency position in response to the finding and recommendations cited in the subject report.

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Rebecca L. Davies

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FINDING: DCMA representatives did not document why a 21% increase in pension costs occurred for the TRW Salaried Pension Plan (the TRW Pension Plan) immediately following the Northrop Grumman acquisition of TRW. They did not document the cause of the increase because the scope of various CIPRs did not address all of the pension-related events that may have caused the increased pension costs at the time of acquisition. As a result, DoD has no assurance that the increased costs to the TRW Pension Plan at the time of the Northrop Grumman acquisition are reasonable.

RECOMMENDATION 1:

Require a Contractor Insurance/Pension Review of the pension-related events that occurred at the time of the Northrop Grumman acquisition of TRW.

DCMA COMMENTS:

Nonconcur. In accordance with the DFARS guidance and the DCMA Guidebook, the DCE is responsible for determining the scope of the CIPRs performed at the time of mergers and thereafter as needed. The CIPR reviews performed by DCMA in 2004, while each was limited in scope, provided the information the DCE needed to make prudent decisions pertaining to the contractor's pension accounting and associated costs. The data from the reviews provided by the CIPR Team on the actuarial assumptions underlying the pension plans gave the DCE comprehensive information that ensured the pension costs were reasonable. Additionally, the DCE stated that he had all the information needed at the time to make his decisions and to determine the pension cost reasonableness related to the acquired pension plans.

A comprehensive CIPR of the pension-related events is unlikely to find significant unallowable cost and would be of no value to the DCE, the customer and primary user of the CIPR report. To prepare an additional CIPR report that is not a value added product for the customer is contrary to the DCMA business practice of deploying resources in response to customer needs and requirements.

RECOMMENDATION 2:

Update existing Contractor Insurance/Pension Review guidance in the Defense Contract Management Agency guidebook as follows.

A. Require CIPR teams to maintain documentation supporting the decision not to conduct a Contractor Insurance/Pension Review when high-risk issues are present but a Contractor Insurance/Pension Review is not conducted.
B. Include a change in the percentage of a contractor's Government-to-commercial workload as a high-risk event.

DCMA COMMENTS:

Nonconcur. As the IG plans, and continues, to conduct a series of audits of the pension plans at the five largest DoD contractors, DCMA intends to evaluate and address all recommendations for changes to the Agency's guidance in a comprehensive manner when the series of IG reviews are completed. The DCMA comprehensive response to be supplied as DCMA comments to the last IG review in the series will encompass all recommendations suggested in this series of IG reports on pensions to the Agency Guidebook. The comprehensive response will avoid developing solution(s) that are contractor-specific based on the situation and circumstances.

DCMA has already updated the Agency's Guidebook to reflect the current requirements outlined in the DFARS. The references in the Guidebook automatically link into the updates in DFARS - Chapter 242, the PGI as they occur. Some minor editing has been done to show the current $50 million threshold for contractor sales.

NOTE: When the CIPRs were performed at the request of the DCE, the Guidebook and DFARS were in tandem.

Background: Pension Plan Assets (IG Comments on report page 1)

Pension Plan Assets. Defense contractors charge DoD for costs associated with each pension plan having participants who perform Government work. These pension costs charged to Government contracts are not paid as benefits during the performance of the contract. Rather, the pension costs are accumulated as Government-funded assets in a pension trust for future payment of benefits when the employees retire. Once DoD is charged for and pays pension costs for a business segment with Government contracts, these contributions are accounted for as assets of the segment. If a business segment is sold, the parties may agree to a continuation of the pension plan with the buyer and a corresponding transfer of the Government-funded pension assets and liabilities to the successor contractor. If the pension plan is retained by the seller, a settlement is negotiated with the Government as an adjustment to the previously paid pension costs.

DCMA comments on the section titled Pension Plan Assets:
The information about Pension Plan Assets included in the Background section of the IG report accurately describes how a contractor segment that separately computes pension cost per CAS 413.50(c)(5) is reimbursed when the segment performs 100% of its work on Government cost-type contracts. However, as it relates to contractors that perform less than 100% of segment work for the Government, the description is incomplete.

In instances where the contractor's work is less than 100% Government cost-type contracts, as was the case at TRW, the contractor is only reimbursed for the share of pension cost that is allocated to Government cost-type contracts. When a contractor performs work for fixed-priced type contracts, the contractor is paid the contract price without regard for the pension cost actually incurred. Although only part of a segment's pension cost is paid through the Government's cost and fixed-price-type contracts, the entire pension cost computed for the segment is used to compute the segment contribution (CAS 413.50(c)(5) [allocation rules]) and the entire pension contribution for the segment is separately tracked (CAS 413.50(c)(7) [segment accounting]).

When a segment is sold and the entire pension liability and assets of the segment are transferred to a buyer, no adjustments to past pension cost are required by CAS 413.50(c) (12) [segment closing adjustment]. In other circumstances, CAS 413.50(c) (12) describes the calculation of the segment closing adjustment amount and the fraction of that adjustment amount that is due to government contracts.

Pension Plan Costs After the Northrop Grumman Acquisition of TRW:
(Finding Paragraph stated on page 3 of report):
DCMA representatives did not document why a 21 percent increase in pension cost occurred for the TRW Salaried Pension Plan (the TRW Pension Plan) immediately following the Northrop Grumman acquisition of TRW. They did not document the cause of the increase because the scope of various CIPRs did not address all the pension-related events that may have caused the increased pension costs at the time of acquisition. As a result, DoD has no assurance that the increased costs to the TRW Pension Plan at the time of the Northrop Grumman acquisition are reasonable.

DCMA comments on the section titled DoD Pension Cost Changes:
The CIPR of the TRW Salaried Pension Plan did not comment specifically on pension cost increase because the scope of the CIPR was limited to the transfer of pension plan assets. The transfer of plan assets occurred. The transfer of plan assets is the largest element of risk when a company is sold, especially if parts of the company are immediately spun off as was the case with TRW. Any shortfall in transferred assets without an adjustment to future actuarial cost measurements would result in the shortfall showing up as increased pension cost. In the TRW plan, any assets transferred out of the plan were only those required to satisfy the existing plan accrued benefit liability. Pension plan assets net of satisfying these obligations were properly transferred in total to NG. During the course of the CIPR review, the TRW defense and BSC home office segments were found to be separately computing cost per CAS 413.50(c)(5). When the commercial segments were sold, all assets of the defense segments or of the BSC

home office segment would be accounted for once the CAS 413.50(c) (7) records were verified. The CIPR effort was a supporting part of DCAA Report No. 4721-2004F19413001. This DCAA audit report verified the physical transfer of the assets in the NG financial records. This DCAA audit report represents the joint DCMA/DCAA CIPR report as described under DFARS 242.7302 (in 2003 moved and clarified in DFARS Practice Guidelines and Instructions (PGI) 242.7302.)

A CIPR (DCMA report 068-04; listed on page 6 of the IG report) is described as having "examined pension plan costs forecasted for 2004, including the TRW Pension Plan", but the IG asserted that the CIPR reports had insufficient scope stating, "the scope of these CIPRs did not address the specific pension-related events identified in this IG report." The CIPRs listed on page 5 of the IG report, section titled CIPRs, are acknowledged to examine and cover pension cost reasonableness. These CIPR reports gave the DCE adequate assurance that the pension cost at Northrop Grumman was reasonable. The IG report did not reach the same conclusion as the DCMA CIPRs did because the IG stated, "the scope of these CIPRs did not address the specific pension-related events identified in this IG report". However, these pension-related events identified by the IG are not associated with any unallowable cost. From an actuarial perspective, the CIPRs determined that the actuarial assumptions underlying each of the pension-related events are reasonable; hence the resulting costs are reasonable. To restate in another way, in the actuarial evaluation of pension costs, it is the underlying assumptions that are evaluated for reasonableness. If the underlying assumptions for the pension plan are each determined to be reasonable from an actuarial perspective, the resulting pension cost are reasonable.

No unallowable cost is associated with the four pension-related events identified on page 4 of the IG report.

The DCMA CIPR Guidebook currently states:

1. Risk Planning

1.2. In consultation with the CIPR Teams and DCAA, the ACO determines when a CIPR is required, based on the contractor's qualifying sales and any special circumstances. See DFARS 242.7302 for further guidance in determining when a CIPR should be conducted. The ACO determines the scope of the CIPR based upon those specific aspects of a contractor's insurance or pension program that represent a high risk. The risk should be determined by comparing the likelihood with the financial consequence of contractor non-compliance with FAR, the Cost Accounting

Standards (CAS), or contract clauses relative to insurance, pension and other deferred compensation plans

2.1. A high risk exists when there is a large likelihood that a significant cost is unallowable. This rating is appropriate where, for example:

- A Segment Closing, Plan Merger or Spin-Off is anticipated or has occurred and the contractor maintains a defined benefit pension plan, self-insurance, and/or a reserve for a Post Retirement Benefit (PRB) plan; a Forward Pricing Proposal has been submitted which includes a defined benefit pension plan, self-insurance or PRB plan; an Incurred Cost Audit is scheduled and the contractor has a defined benefit pension plan that is not fully funded; an Incurred Cost Audit is scheduled and the contractor maintains a reserve for funding a PRB plan; an Indemnification Agreement is to be reviewed and validated; and the Qualifying Sales of a new or existing contractor reaches the $40 million threshold.

The referenced Agency Guidebook states that high risk issues are evaluated jointly by the CIPR Team, DCAA, and the ACO, with the ACO making the determination for the need of a CIPR and its scope. None of the pension-related events cited in the IG report indicate a failure of the application of the DCMA Guidance. Performance of a comprehensive CIPR as recommended by the IG at this time would have no value to any customer. Hence, it should not be performed. From an actuarial perspective, it is reasonable for the CIPR reports to have made no comments on the four pension related events cited by the IG. In any review, the practice is to comment only on items that raise an issue; the practice is not to comment on items that do not raise an issue.

The IG dismissed the other CIPRs performed on pension cost at Northrop Grumman because the four pension-related events as identified by the IG were not commented on in those CIPR reports. Such a dismissal by the IG downplays the value that these CIPR reports represent to its user, the DCE. In fact, the DCE was assured by these CIPR reports that pension cost was reasonable. These CIPR reports evaluated increased pension cost by evaluating changes in the underlying actuarial assumptions and found them to be reasonable.

a) Long-Term Valuation Rate (IG finding, report page 4)

DCMA Response:
Topic as defined by DCMA: Actuarial valuation interest rate assumption change.

Topic as defined by DCMA: Actuarial valuation interest rate assumption change.

A change in corporate management or pension plan sponsorship usually results in a change to the actuarial assumptions or a conforming of actuarial assumptions to that of the successor plan(s). The formal follow-on Special CIPR report 083-05 covered the change in plan actuarial assumptions. Both long term valuation interest rates used by TRW and NGC, 8.5% and 8.0% respectively, were found to be in the range of reasonableness by the CIPR Division. Although increased cost results from management changes to the interest rate assumptions in some of the pension plans, all of which are now under the same management, none of the resulting increased pension cost is unallowable.

b) Forward Pricing Long-Term Investment Rate (IG finding, report page 4)

DCMA Response:
Topic as defined by DCMA: Forecast long-term interest earnings assumption.

Forward pricing pension cost analysis was addressed in another joint DCAA/DCMA review. This project was initiated by DCAA requesting formal technical assistance on the post-merger pension costs. A CIPR report, 039-03, was attached to the DCAA audit report. The DCAA audit report represents the initial joint DCAA/DCMA Special CIPR for the post-merger pension costs. In the forward pricing proposal, the contractor assumed that the plan asset expected return was 8.5% while the liability valuation rate was 8.0%. These contractor assumptions resulted in actuarial asset gains which reduced the annual CAS pension cost during the forecast period. This scenario was determined to be an acceptable methodology.

c) BSC Home Office Pension Costs Allocation (IG finding, report page 5)

DCMA Response:
The IG finding suggests that the BSC pension cost can be separated into two parts: pension cost associated with prior commercial enterprises and pension cost related to prior and ongoing government work. That is not correct. CAS 413.50(c) (5) refers to CAS 413.50(c) (2) and (c) (3) giving the circumstances that enable the government to insist that pension cost be computed separately, i.e., segment accounting. CAS 413.50(c) (5) cannot be applied to BSC. CAS 413.50(c) (4) is applicable to BSC, and it states, "For a segment whose pension costs are required to be calculated separately pursuant to paragraphs (c) (2) or (3) of this subsection, such calculations shall be prospective only; pension costs need not be re-determined for prior years." Segment accounting can be applied to BSC only on a prospective basis. On a prospective basis, BSC no longer has any allocation to commercial segments as those segments were sold after the merger.

The additional cost associated with paying subsidized lump sums for the departing TRW employees who are attributed to the commercial work shows up in the pension asset actuarial valuation as an actuarial loss. CAS 413.50(a)(2) does not permit this actuarial loss to be assign to prior years, instead the loss "shall be amortized over a 15 year period in equal annual installments, beginning with the date as of which the actuarial valuation is made." This reiterates CAS 412.50(a) (1) (iv) which specifies that the amortization payment part of computed cost is assignable to the period for which it is computed. If a pension cost assigned to the current period is funded, then it is allocable to the cost objectives of the period (per CAS 412.50(d) and (d) (1); (d) (2) does not apply to this situation). The BSC pension cost allocated to the government segments meets the requirements of CAS.

The IG report on page 5, BSC Pension Cost, sentence 3, is correct in stating that the BSC segment represent the TRW corporate headquarters employees who have performed work on multiple cost objectives from all four TRW business segments, both Government and commercial. Prior to the merger, TRW commercial and Government business segments were allocating their allocable share of pension cost. The CAS pension assets of BSC include assets attributable from both Government and commercial sources. After the two commercial segments were sold, the BSC employees still perform work on multiple cost objects, but now there are only cost objectives from the two remaining Government segments. The pension cost measured is only assignable to the current period and is only allocable to the current remaining Government segments. It is impermissible to attempt to disallow cost as identifiable to commercial objectives when that identification is contrary to CAS rules for measuring, assigning and allocating cost. That would be contrary and noncompliant with FAR as well. The DCMA CIPR Team concludes there are no improprieties in the accounting for pension costs for BSC.

d) New Line Item (IG finding, report page 5)

DCMA Response:
Topic as defined by DCMA: Addition of Line Item paid by government.

The document used for this IG conclusion shows pension cost related to a commercial business unit within a government segment. There was a new line item in the cost pool that includes pension costs. The cost allocation procedures of the contractor, which allocates cost from the cost pool, insure that only that portion of the cost in the pool allocated to Government contracts is recovered on Government contracts. Although a segment is designated as a Government or commercial segment, this does not imply that 100% of the work performed by the segment is for government or commercial cost objectives as per the segment designation.

DCMA Supplemental Information
(Response to Provide General Background Information)

The CIPR Team performs an actuarial analysis of the contractor's pension cost. The following background information is provided for a better understanding of the actuarial role in the determination of allowable pension costs and their flow as costs to Government contracts.

The Flow of Pension Cost to Contracts:
Defense contractors are paid for work on defense contracts as set out by FAR and DFARS. Pension costs are allocated to contracts and other cost objectives that have a causal and beneficial relationship to the costs. To describe pension costs as charged against contracts is true, but that hides important details more accurately, contract payment includes pension cost. For fixed-price-type contracts, it is included in the negotiated price. For cost-type contracts, it is the amount of measured pension cost allocated to the cost-type contracts.

The total pension contribution made by the contractor includes cost for all its segments, including commercial work, CAS covered Government work and non-CAS covered Government work. A contractor may calculate total company pension cost and allocate it to segments by payroll or another base. CAS 413 prefers (and requires in certain circumstances) that cost be calculated separately for a segment. For purposes of CAS 413.50(c) (7), the contribution for each segment is accumulated as segment assets, separately tracked for income and expenses, and is used to compute the segment cost. This is commonly called segment accounting or accounting for government assets. Segment pension cost calculated using these segment assets is fairer than total plan cost allocation by payroll because pension cost is based on more factors than just payroll. Only the particular segment benefits from these segment assets. If the segment is sold and all its pension assets and liabilities are transferred to the buyer, no one-time immediate adjustment for pension cost is required. If any other arrangement is made, an adjustment for pension cost is required under CAS 413.50(c) (12) [segment closing adjustment].

Further identification of pension assets within the segment is not practicable and would be contrary to CAS and FAR. Identification of pension cost actually paid through fixed-price (FP type) contracts is difficult. When a FP type contract is established, the contract price is fixed through some combination of competition and/or negotiation. Where the price is negotiated, the contractor estimates the cost of the contract over its expected performance period, presents the government with a price proposal and cost and pricing data, and negotiates the contract price. When costs, including pension cost, are allocated to cost objectives, those cost objectives include FP type contracts. The amount of pension cost allocated to FP type contracts is not necessarily the amount of pension cost contributed by the contractor attributable to FP type contracts. The contractor is paid the negotiated contract price without regard for the actual pension cost during the FP type contract performance period. There are no standard methods for determining how much of a FP type contract payment is for pension cost.

Identification of cost allocated to cost-type contracts is easier. All contracts, including FP type, are allocated their share of the cost pools in proportion to bases; the pools and bases are disclosed by the contractor and are governed by Cost Accounting Standards (CAS). Generally, pension cost is first included in a compensation pool which is often allocated to lower tier pools such as engineering labor pools and corporate office pools; in turn, these cost pools flow down into lower tier pools until all pools are applied directly to contracts and other cost objectives. This allocation model is approximated by sales; that is, the cost-type contract sales of the segment divided by total sales, times segment pension cost equals the cost paid through cost-type contracts. Allocating cost pools by sales, however, ignores other allocation models such as those based on labor costs, and some contracts are more labor intensive than others.

The assets separately tracked by the segment are the proper assets for computing segment cost. These assets are not necessarily 100% funded by the Government; the Government has funded only the assets in proportion to its share of the segment's total business. Under segment accounting, the assets will benefit the segment only, rather than the entire plan. This was the case in the NG acquisition of TRW.

Measurement, Assignment, and Allocation of Pension Cost:

Pension cost is like other contract cost for the purposes of contract pricing and cost pooling, generally. However, pension costs have unique characteristics that are addressed in the Cost Accounting Standards. Pension costs are actuarially determined amounts of money to be set aside today so that this money and its accumulated interest will pay lifetime benefits in the future to workers who stay until their retirement. The actuarial methods for determining pension cost spread unexpected changes in pension costs over future periods, not prior periods. This ensures that, over a period of time, the pension costs, while arguably overstated or understated for a given year fairly represents the pension costs for the longer period. CAS 412 and 413 do not require a restatement or recomputation of prior period pension costs when the actuarial assumptions of prior periods are proven wrong. Rather, they deem the computed pension costs as the cost for the period, CAS 412.40(a) (1). Actuarially, the computed pension costs for a given year includes corrections (i.e., actuarial gains and losses) for prior years and thus, pushes unanticipated changes into future years. This paradigm fails when there are no future cost accounting periods over which corrections for pension costs can be corrected. CAS addresses this explicitly and calls for a one time adjustment of previously determined pension costs when a segment is closed, sold, or another CAS 413.50(c) (12) [segment closing adjustment] event occurs.

CAS calls for the use of the historical records of the segment's pension cost to determine the one time segment closing adjustment, CAS 413.50 (c) (12). However, CAS includes exceptions where the contractor need not track pension costs separately by segment, and an equitable base is used to divide the pension assets as an alternative. When the contractor keeps historical records of a segment's pension cost, the assets assigned to the segment are those accumulated as contributions made for the entire segment, including those attributed to commercial contracts, and not only those related to Government cost and FP type contracts. These pension assets, separately tracked by segments, include dollars related to work done by the segment on cost objectives that are unrelated to the Government, as well as work not subject to the Cost Accounting Standards. The CAS 413.50(c) (12) rules recognize this and describe fractions to apply to obtain the adjustment amount.

The segment allocation records kept under CAS 413.50(c) (7) [segment accounting] are the basis for settlement under CAS 413.50(c) (12) [segment closing adjustment]. The purpose of CAS 413.50(c) (12) is to make a one time segment closing adjustment for adjustments that would otherwise take place over future accounting periods in the absence of a segment closing. In shorthand, this is sometimes expressed as "returning excess Government-funded assets". As a shorthand expression, this adequately describes the CAS 413.50(c) (12) segment closing adjustment, but it is inaccurate when applied to the CAS 413.50(c) (7) [segment accounting] record keeping. The pension assets separately accounted for are the total segment assets; it is not a record of the Government contribution toward the pension cost of the segment.

The CAS 413.50(c) (12) segment closing adjustments for previously determined pension costs are to recover the adjustments that would have normally, in the absence of segment closing, been allocated to future cost accounting periods. Hence, when a segment stops performing on Government contracts, a CAS 413.50 (c) (12) segment closing adjustment is required even though the segment continues operations. However, CAS requires no adjustment when all pension assets and liabilities of a segment are transferred to a buyer.

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