United States General Accounting Office 130193

GAO

Report to the Secretary of Defense

June 1986

PENSION COSTS

Oversight of Contractor Pension Costs Could Be Improved

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GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-221036

June 23, 1986

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

We have completed an assessment of the adequacy of the Department of Defense's (DOD's) audits of contractor pension costs. Contractor pension costs represent a significant element of defense contract costs. DOD spends $3 billion annually for its share of contractors' pension contributions included in contract prices. To monitor these costs, DOD relies on the Defense Contract Audit Agency (DCAA) and the Defense Contract Administration Services (DCAS)—an arm of the Defense Logistics Agency (DLA). Both agencies provide oversight of contractors' pension costs—DCAA as part of its regular contract audit responsibilities, and DLA through specialized DCAS contractor insurance/pension reviews.

We found that the combined efforts of DCAA and DCAS have resulted in adequate audit coverage of contractors' pension costs. DCAA and DCAS, however, were performing independent pension reviews covering the same contractors' pension costs without adequately coordinating their efforts. We also found that DOD computes disallowances for late funding of pension plans based on contractors' valuation assumption rates These rates are calculated using assumptions based on the return experienced by the pension funds' assets. These actuarially determined rates were generally lower than short-term interest rates available in the market place during the time period of our review. Thus, contractors had an incentive to defer funding of their pension plans to the financial detriment of the government and the contractors' other customers.

DCAA and DCAS review pension costs for many of the same contractors, but use different criteria and approaches. DCAA reviews pension costs, when such costs are material, as part of its overall audits of contractors' incurred costs and forward pricing proposals. DCAS reviews pension costs for all contractors meeting a $10 million sales threshold under a specialized insurance and pension review program Thus, DCAA reviews costs charged to specific contracts, whereas DCAS reviews overall pension costs. However, the objectives of each agency's review are basically the same—to review contractor compliance with the Cost Accounting Standards (CAS) and the Federal Acquisition Regulations (FAR) in the interest of obtaining fair and reasonable prices.

DCAA has 6 regional offices, each having from 18 to 24 field audit offices that are responsible for the day-to-day audit work and receive technical assistance and guidance from their respective regional offices. The regional offices, in turn, look to headquarters for policy guidelines.

DCAS provides contract administration services through 9 regional offices, each responsible for 4 to 15 local contract administration offices. Its contract insurance branches operating out of three regions—New York, Chicago, and Los Angeles—do contractor insurance/pension reviews for all DLA contractors nationwide.

Each agency acquires audit cognizance in a different way. Pension costs are overhead costs which DCAA is responsible for auditing. As a result, DCAA defines its contractor universe in terms of contractor divisions. We reviewed only three of DCAA's six regions. In total, we identified 329 CAS covered contractor segments in the 3 DCAA regions under review. DCAS, on the other hand, makes its insurance/pension reviews in terms of the contractor's total organization which generally includes all company segments. This definition more closely corresponds to how the contractors administer their pension plans. As of January 1984, DCAS had reported 258 contractors subject to review nationwide.

Pension plans and the manner in which they are administered by contractors vary. Contractors often have many pension plans, including companywide salary plans and divisional hourly plans. Both types of plans are usually administered at the corporate level, although divisional plans are sometimes administered locally.

Our review covered 30 pension plans maintained by 22 contractors. A detailed discussion of our objective, scope, and methodology is in appendix I.

Increased Coordination Needed

DCAA and DCAS sometimes made separate reviews of the same contractor pension plans without coordinating their efforts. Taken together, these reviews have generally provided adequate audit coverage of contractor pension costs. Nevertheless, better coordination of reviews could reduce the potential for duplication of audit effort and improve cost effectiveness. DOD's pension oversight could be further improved through a clearer definition of each agency's role and responsibilities during joint reviews.

DCAA and DCAS pension reviews provide largely the same information to contracting officers on the same pension costs, although not necessarily at the same time and in the same manner. Because of this overlap, both agencies have instituted written procedures requiring coordinated insurance/pension reviews and reports, with DCAS designated as the team captain and DCAA as a team member. Our review of completed DOD pension audits showed, however, that DCAA and DCAS had not adhered to the requirement for coordinated team reviews and reports As shown in table 1, DCAA and DCAS had conducted coordinated team reviews for only 12 of the 30 pension plans we sampled.

Table 1: Plans Reviewed by DCAA and DCAS

DCAS/DCAA region	Coordinated reviews	Independent reviews	Other[a]	Total plans sampled
New York/ Philadelphia	•	6	2	8
Chicago	4	3	•	7
Los Angeles	8	5	2	15
Total	**12**	**14**	**4**	**30**

[a]Contractors' plans did not meet one or the other agency's criteria for review

The DCAS New York region and DCAA Philadelphia region—which cover largely the same territory—showed the lowest degree of coordination. Both DCAA and DCAS did their own independent reviews with little or no reliance on the other's work.

In the Chicago region, both agencies' pension reviews were made on a coordinated team basis for four of the seven pension plans we reviewed Agency reports were not coordinated in any of these reviews.

In the Los Angeles region, we found that insurance/pension reviews were coordinated for 8 of the 15 plans we evaluated (coordination was not applicable for 2 plans). DCAA's Los Angeles region had initiated an experimental insurance/pension review program which has helped to improve coordination. All 15 plans in our sample were reviewed before this program was initiated.

The lack of coordination is counter to DOD's audit policy and is caused in part by DCAA programming its audits at the local level. By failing to adhere to established policies for coordination of reviews and reports, DCAA and DCAS regions have increased the potential for duplicating the audit effort. In addition, our review showed that existing DCAA and DCAS coordination procedures do not define each agency's responsibilities during coordinated reviews, or fix overall responsibility for making CAS and FAR compliance determinations.

.mproved Coordination Observed

During our review, DCAA and DCAS did make efforts to improve coordination. Early in 1983, the DCAA Los Angeles region implemented an experimental program to oversee insurance and pension reviews. The region designated a full-time staff position to

- develop an insurance/pension program plan,
- coordinate insurance/pension reviews with DCAS,
- direct and monitor all pension audits in the region, and
- develop regional capability to do pension reviews for those contractors not covered by DCAS.

Under this program, the region plans and monitors all pension audits undertaken to ensure more effective audit coverage and coordination. A major element in the experimental program is the increased emphasis o planning and coordination. This increased emphasis should result in improved coordination and lessen the potential for duplication. As of th completion of our review, DCAA had not evaluated the results of this experimental program.

DCAA and DCAS regions in Chicago have also tried to improve coordination of their reviews. Regional representatives of the agencies met in May 1983 to formalize the roles and responsibilities of each agency in the joint review process. The DCAA staff proposed a coordinated progra for insurance/pension reviews. The draft procedures outlined the benefits to be derived through improved delineation of the review process, and proposed a system to share responsibilities in planning, executing, and reporting on the results of joint reviews In planning, for example, the procedures called for regional representatives to jointly prepare an annual schedule for reviews which would be based on materiality, risk to the government, and time between reviews. The procedures also proposed dividing responsibilities for CAS compliance as follows:

Table 2: CAS Review Areas

	Assignment of CAS review areas			
Area of cost	**DCAS**	**DCAA**	**Joint**	**Tot**
Insurance	8	5	10	[illegible]
Pension	3	4	19	[illegible]
Deferred compensation	•	2	3	

The DCAS region, however, basically rejected the draft procedures, indicating that in its view the procedures impinged on DCAS' responsibilities under FAR. The region suggested, instead, that DCAA's role be limited to providing information on contractor operations and DCAA adjustments, and analysis and verification of data at the point of entry in the contractor's accounting system. The DCAS region concluded that should DCAA and DCAS want to delineate responsibilities, a plan should be developed at the headquarters level, and not locally.

Taken together, these agencies' reviews generally provide adequate audit coverage of contractors' pension costs. Nevertheless, in some areas we found that each agency did independent pension reviews without coordinating their efforts as required by both agencies' procedures. As a result, there is a potential for duplication of audit effort. We believe that better coordination of pension reviews, to the extent practicable, will improve the government's stewardship of this already large, and growing element of cost.

Late Funding of Pension Costs

In our review of the DOD audit and oversight of pension costs, we observed a specific area which warrants further study and action by DOD This area deals with the timing of contractors' funding of pension costs.

When contractors fail to fund pension costs allocable to government contracts on a timely basis, the pension plan loses the opportunity to earn investment income. This lost investment income, in turn, serves to increase future pension costs to the government. Currently, FAR section 31.205-6 provides that increased pension costs caused by a delay in funding beyond 30 days after each quarter of the year to which costs are assignable are unallowable However, because DOD uses long-term actuarially determined interest rates to compute unallowable costs, contractors had an incentive to defer funding of their pension costs, and in effect, borrow from the pension plan.

DCAA and DCAS routinely monitor the timing of contractors' pension plan contributions as part of their pension reviews, and challenge increased costs when contributions are made less frequently than quarterly. In fact, DOD auditors challenged increased costs attributable to delays in funding for 10 of the 22 contractors in our sample. DOD computes the amount of unallowable costs using contractors' valuation assumption rates. These rates are calculated using assumptions based on the pension plan's past and projected experience These actuarially determined rates are long-term rates which can be substantially lower than current interest rates for corporate borrowing and short-term investments. As a result, contractors have an incentive to defer funding of their pension contributions, or, in effect, to borrow from the pension fund at the generally lower actuarially determined interest rate.

Our analysis of DCAS and DCAA audit reports for contractors in the Chicago area showed violations of Defense Acquisition Regulation[1] quarterly funding provisions in six of the seven plans in our sample. DCAS and/or DCAA identified $1,129,400 in questioned costs for 1980 and 1981 using the contractors' long-term actuarially determined interest rates which ranged from 5 percent to 7.5 percent. Commercial paper[2] or 6-month Treasury bills available to institutional investors in 1980 and 1981 averaged about 12.4 percent and 16.4 percent, respectively, and were significantly more than the long-term rates. For these six pension plans, if costs were questioned using the short-term money market rates, the disallowance would have been $2,443,400, a difference of $1,314,000. This represents the added short-term earnings—computed on the basis of the short-term money market rates—that the funds would have earned if contributions were timely and the fund earned the average money market rate on these contributions. Contractors, in effect, borrowed the money from the pension fund and deprived the government and the contractor's other customers of the current and related future earnings that would be available to offset current and future pension costs.

Table 3 is an illustration of the effect the differential in interest rates can have on contractors' decisions not to fund their pension plans quarterly.

From the sample of 30 plans we examined, table 3 compares, by year, the number of contractors challenged by DOD (col. A); the range of actuarially determined rates of interest (col. B); the average 6-month Treasury bill rate (col. C); and the 6-month commercial paper rate (col. D). Note that as the percentage in column C or D increases over the percentage in column B, the number of contractors (col. A) choosing to defer funding of their pension plan increases proportionately.

[1]The Defense Acquisition Regulation was incorporated into FAR, effective April 1984

[2]Commercial paper is a form of business borrowing whereby the firm sells its notes to a bank or brokerage house, which in turn resells these notes to outside parties A corporation will use commercial paper loans in preference to bank borrowings whenever possible because the effective cost of such borrowing is usually lower than bank rates

Table 3: Comparison of Contractors' Decision to Defer Funding

Rates in percent

Years	Col. A Number of contractors challenged by DOD	Col. B Range of actuarially assumed interest rates	Col. C 6-month Treasury bill rates	Col. D Commercial paper rates
1978	1	7 0	7 58	7 99
1979	2	7 0	10 06	10 91
1980	5	5 0 - 7 0	11 37	12 29
1981	7	5 0 - 8 0	13 80	14 76

The difference between the rates used by DOD to compute the unallowable cost (col B) and either a secure short-term investment (col. C) or average short-term corporate borrowing costs (col. D), appears to be a significant incentive to delay funding. We recognize that the information in table 3 is dated and covers years when the short-term interest rates were much higher than they are today. In all probability, today's rates are more in line with actuarially determined rates which reduces the incentive for contractors to defer pension contributions. Nonetheless, if the method for computing disallowances for late funding of pension plans is left unchanged and short-term interest rates climb again, it is likely that the problem we observed during our review will reoccur.

Conclusions and Recommendations

Our review showed that the combined efforts of DCAA and DCAS have resulted in the adequate coverage of contractors' pension costs. We found, however, that DCAA and DCAS were performing independent pension reviews covering the same contractors' pension costs without adequately coordinating their efforts. We recommend that the Secretary of Defense take steps to assure that DCAA and DCAS improve coordination and adhere more closely to procedures requiring coordinated pension reviews.

We also found that DOD computes disallowances for late funding of pension plans based on contractors' actuarially determined interest rates which, at the time of our review, were generally lower than short-term rates available in the market place. As a result, contractors had an incentive to defer funding of their pension plans to the financial detriment of the government and the contractors' other customers. To eliminate this incentive, we recommend that FAR 31.205-6 be revised to require unallowable costs resulting from late funding of a contractor's pension plan be computed using short-term Treasury bill interest rates or other readily identifiable short-term rates in lieu of actuarially determined interest rates.

Agency Comments and Our Evaluation

A draft of this report was provided to DOD for its review and comment. DOD concurred with our recommendation that DCAA and DCAS improve coordination of pension reviews, and has taken action to formalize administrative guidance toward that end. DOD stated it had designated DLA as the executive agency to perform contractor insurance/pension reviews for the military departments. In conjunction with this designation, DLA was tasked to chair a special ad hoc group to develop administrative guidance and operating review procedures for conducting contractor insurance/pension reviews. The operating procedures would (1) define responsibilities of DLA and DCAA in coordinating reviews, (2) fix responsibilities for making compliance determinations, (3) preclude duplication of government review effort, and (4) eliminate the placing of duplicate demands on contractor personnel for similar information DOD stated these actions would be finalized by June 30, 1986.

DOD disagreed with our recommendation that FAR 31.205-6 be revised to require that unallowable costs resulting from late funding of a contractor's pension plan be computed using short-term interest rates. While DOD agreed that late funding of pension costs results in lost investment opportunity for the pension plan and, therefore, higher net pension costs to the contractor, it did not believe that future pension costs to the government are increased as a result. DOD asserted that it computes allowable pension costs and unallowable pension costs using the same procedures. That is, actuarially determined interest rates are applied when such rates are representative of the experience of the particular plan, and where such rates are not representative, they are challenged by DOD reviewers and adjusted as appropriate to reflect actual plan experience Therefore, according to DOD, the unallowable cost as calculated reduces the amount of pension costs to the level that would have been allowable except for the late funding.

We agree that if the actuarially determined interest rates were representative of recent pension plan experience, then the use of such rates would not result in additional costs to the government. However, since an actuary's interest rate assumption is based on long-term trends, it is often conservative. We found that the actuarially determined interest rates for the contractors' pension plans included in our review were generally not representative of their recent plan experience or short-term interest rates available in the marketplace During the period we reviewed, 21 of the plans earned significantly higher rates of return on their pension fund assets than the actuarially determined rates, whereas 6 plans achieved a lower rate of return. Therefore, unless conservative actuarially determined rates are successfully challenged by DOD reviewers and adjusted to reflect actual plan experience, a portion of the increased pension costs attributable to late funding in such cases would be borne by the government.

CAS 412, which covers the composition and measurement of pension costs intends that contractors' actuarial assumptions be reasonable, but does not provide sufficient criteria to evaluate them. The standard requires that each actuarial assumption (e.g., interest rate, employee turnover, compensation levels, and others) be representative of the contractors' best estimate of long-term trends based on past experience and future expectations. The standard further provides that actuarial assumptions may be evaluated in the aggregate, rather than on an assumption-by-assumption basis.

Although it was not discussed in the draft of this report reviewed by DOD, our review showed that DOD reviewers have difficulty challenging contractors' actuarially determined interest rates, even if found to be unrealistic, unless contractors' assumptions—again in the aggregate—are shown to be unreasonable. Therefore, recent pension plan earnings experience, by itself, generally does not provide a basis for DOD reviewers to challenge contractors' actuarially determined interest rates.

We continue to believe that short-term rates, rather than actuarially determined rates, better approximate the incremental investment earnings lost when contractors do not make pension plan contributions on a timely basis. We acknowledge that there may be other rates that represent contractors' incremental pension fund interest experience. Accordingly, we have revised our report recommendation to provide that FAR 31.205-6 be revised to require unallowable costs resulting from late funding of a contractors' pension plan be computed using short-term Treasury bill interest rates or other readily identifiable short-term rates in lieu of actuarially determined interest rates.

DOD's comments on the draft of this report are included in their entirety as appendix II.

Copies of this report are being sent to the Chairmen, Senate Committee on Governmental Affairs, House Committee on Government Operations, and Senate and House Committees on Armed Services and Appropriations. Copies will also be provided to other interested parties upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

Objective, Scope, and Methodology

Since nearly all pension costs are charged to the government through contractor overhead pools, DCAA generally approaches this element of cost as an integral part of its audits of contractors' incurred costs and forward pricing proposals. DCAS reviews contractor pension programs under the contractor insurance/pension review program and reviews all DOD contractors having actual or anticipated negotiated contract sales of $10 million or more. Their reviews are done on a cyclical basis and not every contractor is reviewed every year.

DCAS reviews are performed where insurance programs and employee plans are administered, normally at contractors' corporate headquarters. Like DCAA, DCAS evaluates whether contractors' pension costs are allowable under the Defense Acquisition Regulation, and whether they are computed and allocated in accordance with CAS 412 and CAS 413. However, DCAS pension reviewers do not verify cost data to contractor records or quantify amounts for costs questioned beyond a rough estimate of their effect on government work. DCAA is brought in to perform these latter functions.

Our objective on this assignment was to assess the adequacy of DOD's audits and to identify any problems DOD has in auditing pension costs. To accomplish this, we reviewed 30 contractor pension plans. We performed our work at DCAA and DLA Headquarters in Alexandria, Virginia; DCAS regional offices in Chicago, Los Angeles, and New York; and DCAA regional offices and selected branch offices and residencies in the Boston, Chicago, Los Angeles, and Philadelphia regions.

We surveyed DCAA and DCAS to identify the universe of CAS covered contractors subject to pension reviews in the Chicago, Los Angeles, and Philadelphia regions. From this universe, we judgmentally selected a sample of 30 pension plans maintained by 22 contractors for an in-depth review. At these 22 contractors, we reviewed pension plans which collectively had a 1-year cost of $577,212,709. Based on the percentage of government business at each contractor, $356,023,957 of these costs were allocable to government contracts

Our sample was structured to provide (1) a mix of large and small contractors and (2) a mix of hourly and salary plans. We also considered the amount of pension costs charged to government contracts as compared with total pension costs; whether the pension audits were performed by both DCAA and DCAS; and unique situations, such as where the contractor merged two plans into one. We believe this judgmental sample was sufficient to draw conclusions about the performance of the

DCAA and DCAS offices we reviewed. In addition, we interviewed representatives of DCAA, DCAS, and the military services involved in contract audit and administration for pension matters. We reviewed pertinent policies, procedures, guidance memorandums, and other reports and documents considered necessary for our evaluation.

We also made certain tests to determine whether DCAA and DCAS were providing adequate audit coverage of contractors which met established criteria for pension review. For example, we followed up on contractor segments located in one DCAA region, but audited in another region, to ensure that pension coverage was provided. Our review was performed in accordance with generally accepted government auditing standards.

Comments From DOD

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D C 20301-8000

ACQUISITION AND LOGISTICS

DASD(P)(CPF)

7 FEB 1986

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled "Department of Defense Oversight of Contractor Pension Costs Could be Improved Through More Effective and Efficient Use of Audit Resources," dated December 3, 1985, OSD Case No. 6890, GAO Code 942207.

The Department agrees with the findings and recommendation relating to improving the coordination of the Defense Contract Audit Agency (DCAA) and the Defense Contract Administration Service (DCAS) during pension reviews. Efforts are currently underway to develop new procedures and guidance to improve coordination of DoD's pension reviews. This effort will be completed by June 30, 1986. Implementation is planned by late 1986.

The DoD does not agree, however, that short-term interest rates should be used in determining unallowable costs for unfunded pension plans as suggested by the GAO. The current use of actuarially assumed interest rates is appropriate when these rates are representative of plan experience. Contractors' decisions to delay pension plan funding do not impact on the cost of Government contracts, as long as procurement regulation requirements continue to be enforced. In addition, the use of short-term interest rates to determine unallowable costs for unfunded pension plans would result in inequitable treatment in relation to the overall regulations.

The findings and recommendations are addressed in greater detail in the enclosed comments. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,

James P. Wade

James P. Wade, Jr.

Enclosure

DEPARTMENT OF DEFENSE COMMENTS
ON GAO DRAFT REPORT
(GAO CODE NO. 942207)(OSD CASE NO. 6890)

DECEMBER 3, 1985

"DEPARTMENT OF DEFENSE OVERSIGHT OF CONTRACTOR PENSION COSTS COULD BE IMPROVED THROUGH MORE EFFECTIVE AND EFFICIENT USE OF AUDIT RESOURCES"

FINDINGS

Now on pp 1-2 and 7

FINDING A: Oversight Coverage of Contractors' Pension Costs Is Adequate. To monitor its share of contractors' pension contributions included in contract prices, GAO found that DoD relies on two agencies: the Defense Contract Audit Agency (DCAA) and the Defense Contract Administration Service (DCAS). GAO found that DCAA and DCAS review pension costs for many of the same contractors, but use different criteria and approaches. Based on its review, GAO concluded that the combined efforts of DCAA and DCAS have resulted in adequate coverage of contractors' pension costs. (pp. 1-3 and 10, GAO Draft Report)

DOD POSITION: Concur. DoD agrees that DCAA and DCAS are doing a good job of monitoring contractor pension costs.

Now on pp 1-3 and 7

FINDING B: Increased DCAA And DCAS Coordination Needed. According to GAO, because DCAA and DCAS pension reviews provide largely the same information on pension costs to contracting officers, both agencies have instituted written procedures requiring coordinated insurance/pension reviews and reports. GAO found, however, that DCAA and DCAS had not adhered to the requirement for coordinated reviews and reports, having done so for only 12 of 30 pension plans sampled by GAO. In addition, GAO found that existing DCAA and DCAS coordination procedures do not define the responsibilities of each agency during coordinated reviews, or fix overall responsibility for making compliance determinations. Based on its review of the 30 sampled pension plans involving three regional areas, GAO concluded that the lack of coordination is counter to DoD's audit policy and is caused in part by DCAA programming its audits at the local level. GAO also concluded that by failing to adhere to policies for coordination, DCAA and DCAS regions have increased the potential for duplicating audit efforts. (pp. 1, 3-5, and 10-11, GAO Draft Report)

DOD POSITION: Concur. As noted in Finding C, DoD has already taken steps to improve coordination. In December 1983, during the period of the GAO audit, DoD designated the Defense Logistics Agency (DLA) as the Executive Agency to perform Contractor Insurance/Pension Reviews (CIPRs) for the Military Departments. In conjunction with this designation, DLA was tasked to chair a special ad hoc group to develop administrative guidance for inclusion in the Defense Federal Acquisition Regulation Supplement (DFARS). The ad hoc group was also directed to develop operating review procedures for conducting

CIPR. The operating procedures would (i) define responsibilities of DLA and DCAA in coordinated insurance/pension reviews, (ii) fix responsibilities for making compliance determinations, (iii) preclude duplication of Government review effort, and (iv) eliminate the placing of duplicate demands on contractor personnel for similar information. Accordingly, the Defense Acquisition Regulatory Council established Case No. 84-127 to address this issue. The operating procedures and DFARS administrative coverage should be finalized by June 30, 1986.

FINDING C: Improved DCAA And DCAS Coordination Observed. During its review, GAO noted that DCAA and DCAS made efforts to improve coordination. For example, GAO reported that in early 1983 the DCAA Los Angeles region implemented an experimental program to oversee insurance and pension reviews. Under this new program, GAO found that the region programs and monitors all pension audits undertaken to ensure more effective audit coverage and coordination, with increased emphasis on planning and coordination. GAO concluded that this increased emphasis should result in improved coordination and lessen the potential for duplication, but noted that as of March 1985, DCAA has not evaluated the results of this program. A second example of attempted coordination improvement cited by GAO involved the DCAA and DCAS regions in Chicago. GAO found that regional representatives met in May 1983, to formalize the roles and responsibilities of each agency in the joint review process. However, according to GAO, DCAS basically rejected the draft procedures because they impinged on DCAS' responsibilities under the Federal Acquisition Regulation (FAR). According to GAO, DCAS regional people then concluded that should DCAA and DCAS want to delineate responsibilities, a plan should be developed at the headquarters level, not locally. (pp. 5-7, GAO Draft Report)

Now on pp 4 and 5

DOD POSITION: Concur. The actions already taken by the DoD described in response to Finding B, have resulted in improved DCAA and DCAS coordination. Formalized agreement to the DFARS administrative coverage and operating procedures described in response to Finding B will delineate responsibilities of DCAA and DCAS. These procedures will be implemented in late 1986 at the various DCAA and DCAS field organizations responsible for participating in CIPRs.

FINDING D: Late Funding Of Pension Costs By Contractors. According to GAO, when contractors fail to fund pension costs allocable to Government contracts on a timely basis, the pension plan loses the opportunity to earn investment income, which in turn serves to increase future Government pension costs. Under FAR Section 31.205-6, GAO reported that increased pension costs, caused by a funding delay beyond 30 days after each quarter, are unallowable. GAO found that DCAA and DCAS routinely monitor the timing of contractors' pension plan contributions, and challenge increased costs when contributions are made less frequently than quarterly, having done so for 10 of the 22 contractors sampled. GAO also found, however, that DoD computes the amount of unallowable costs using actuarially assumed interest rates, which can be substantially lower than current interest rates for corporate borrowing and short-term investments. As an example, GAO cited six plans in the Chicago area in which DCAS and/or DCAA identified $1,129,400 in questioned costs for 1980 and 1981. According to GAO, had costs instead been questioned on the basis of the short-term money market rates, the disallowance would have been $2,443,400, representing a difference of $1,314,000. GAO concluded that because DoD computes disallowances based on actuarially assumed interest rates, contractors have an incentive to defer funding of their pension plans to the financial detriment of the Government and the contractors' other customers. (pp. 7-11, GAO Draft Report)

Now on pp 5-8

DOD POSITION: **Non-Concur.** While DoD agrees that late contractor funding of pension costs results in lost investment opportunity for the pension plan, DoD does not agree that future pension costs to the Government are increased as a result. As noted by the GAO, FAR Section 31.205-6 provides that increased pension costs, caused by a funding delay beyond 30 days after each quarter, are unallowable. The purpose of this provision is to ensure that late funding does not increase future pension costs to DoD.

The Government would incur a financial detriment if a pension plan with late payments were eventually reimbursed more than if the late payments had not occurred. The DoD, however, computes allowable pension costs and unallowable pension costs using the same procedures. Actuarially determined interest rates are applied when such rates are representative of the experience of the particular plan. Where they are not representative, they are challenged by the reviewers and adjusted as appropriate to reflect actual plan experience. These same procedures apply to the calculation of both allowable and unallowable costs. Accordingly, the unallowable costs as calculated reduces the amount to the level that would have been allowable except for the late funding, and the unallowable amount is not permitted to be recovered by the contractor, either in the accounting period involved, or in a future period. The procedures do not result in any additional costs to the Government, therefore, so long as the procurement regulation requirements are complied with. The GAO did not identify such a problem.

In summary, the DoD agrees that late funding of pension costs by a contractor results in lost investment opportunity and, therefore, higher net pension plan costs to the contractor. The DoD also agrees that the type of disparity between short-term market interest rates and actuarially determined interest rates existing at the time of the GAO review could lead a contractor to make a conscious decision to delay pension plan funding in lieu of other investment opportunities. The contractor, however, then must properly bear the higher pension plan costs, since the DoD procurement regulations do not permit the situation to cause additional allowable costs that may be passed on to the Government.

RECOMMENDATIONS

RECOMMENDATION NO. 1: GAO recommended that the Secretary of Defense take steps to assure that DCAA and DCAS improve coordination and adhere more closely to procedures requiring coordinated pension reviews. (p. 11, GAO Draft Report)

Now on p 7

DOD POSITION: Concur. As discussed in response to Findings B and C, DoD has already taken action to improve the coordination between DCAA and DCAS on pension reviews. DAR Council action will formalize and incorporate administrative guidance for insurance and pension reviews in the DFARS by June 30, 1986.

Now on pp 7 and 8

RECOMMENDATION NO. 2: GAO recommended that FAR 31.205-6 be revised to require unallowable costs resulting from late funding of a contractors' pension plan be computed using short-term interest rates in lieu of actuarially assumed interest rates. (p. 11, GAO Draft Report)

DOD POSITION: Non-Concur. As discussed in the DoD response to Finding D, late funding of pension plans does not increase costs to the DoD. Therefore, a revision of the current regulations is not warranted.

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