



# CAS: The Series – Episode 4: The Compensation Standards

Forvis Mazars US

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# Agenda

## Layout of Series

## The Compensation Standards

- CAS 408 – Costs of Compensated Personal Absence;
- CAS 412 – Measurement of Pension Costs;
- CAS 413 – Adjustment and Allocation of Pension Cost; and
- CAS 415 – Cost of Deferred Compensation

# Polling Question #1

- Where are you working from today?
  - Home or alternate work location
  - My company office
  - A different work location
  - Travelling
  - Other

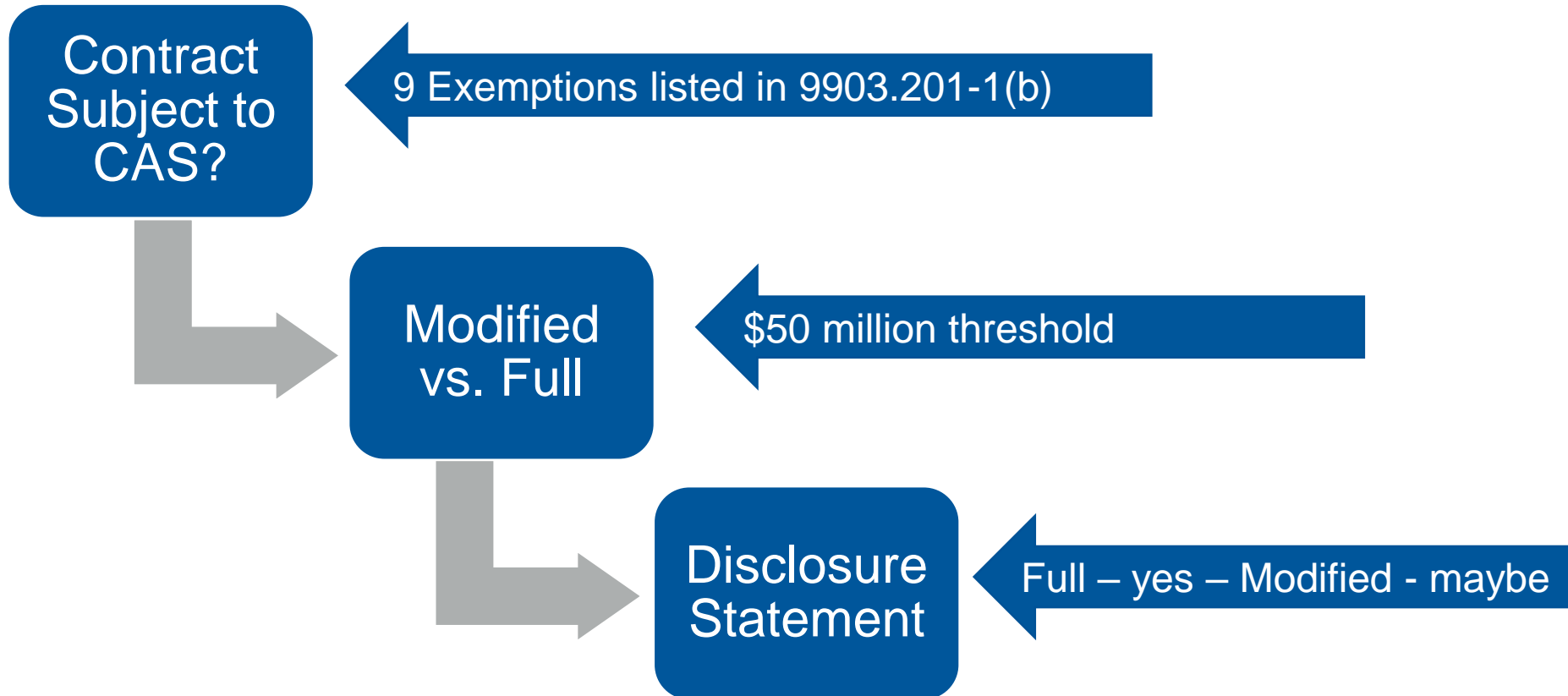


# Layout of the Series



# CAS in a minute!

- Contracts are subject to CAS – not contractors!



# Layout of CAS the Series

- Pilot Episode – 90-minute webinar to kick off the series
- **Individual 90-minute episodes:**
  - Episode 1 – CAS Clauses, Exemptions and Full/Modified CAS
  - Episode 2 – Cost Accounting Practice Changes & Administration
  - Episode 3 – CAS 401, 402, 405 & 406
  - **Episode 4 – Compensation – CAS 408, 412, 413 & 415**
  - Episode 5 – Direct and Indirect Costs – CAS 418
  - Episode 6 – Home office allocations – CAS 403

# Layout of CAS the Series

- Episode 7 – G&A and B&P/IR&D – CAS 410 & 420
- Episode 8 – COM and Standard Costs – CAS 407, 414 & 417
- Episode 9 – Assets & Material – CAS 404, 409 & 411
- Episode 10 – Insurance and CAS 419 – CAS 416 and the mystery of CAS 419
- Episode 11 – Disclosure Statements
- Episode 12 – CAS Administration – Roles of DCMA & DCAA



# The Cost Accounting Standards

- BASIC Standards
  - CAS 401: Consistency
  - CAS 402: Direct v. Indirect Costs
  - CAS 405: Unallowable Costs
  - CAS 406: Cost Accounting Period
- The Cost Allocation Standards
  - CAS 407: Standard Costs
  - CAS 414: Cost of Money
  - CAS 410: General & Administrative
  - CAS 403: Home Office expenses
  - CAS 418: Direct & Indirect
  - CAS 420: B&P and IR&D
- Asset Accounting Standards
  - CAS 404: Capitalization
  - CAS 409: Depreciation
  - CAS 417: Self Constructed Assets
- Compensation Standards
  - CAS 408: Compensated Assets
  - CAS 412 & 413: Pensions
  - CAS 415: Deferred Compensation
- Other Standards
  - CAS 411: Material Costs
  - CAS 416: Insurance Costs

# The Format of the Standards

- Purpose (.20)
- Definitions (.30)
- Fundamental Requirement (.40)
- Techniques for Application (.50)
- Illustrations (.60)
- Interpretation (.61)
- Exemption (.62)
- Effective Date (.63)

# CAS 408

# History

- CAS 408 – Costs of Compensated Personal Absence
  - Published September 19, 1974
  - Took effect on July 1, 1975
- Government concerns – contractors get “interest free” use of money
- Contractor concerns – significant increase in cost of compliance
- GAAP incorporated FAS 43 in 1980:
  - *An employer shall accrue a liability for employees' compensation for future absences if all of the following conditions are met:*
    - *The employer's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered,*
    - *The obligation relates to rights that vest or accumulate,*
    - *Payment of the compensation is probable, and*
    - *The amount can be reasonably estimated.*

# CAS 408, Costs of Compensated Personal Absence

- Improve, and provide uniformity in, the measurement of costs of vacation, sick leave, holiday, and other compensated personal absence for a cost accounting period, and
- Increase the probability that the measured costs are allocated to the proper cost objectives.

# CAS 408 - Definitions

- **Compensated personal absence** means **any absence from work** for reasons such as **illness, vacation, holidays, jury duty or military training**, or personal activities, for which an employer pays compensation directly to an employee in accordance with a plan or custom of the employer.
- **Entitlement** means an employee's right, whether conditional or unconditional, to receive a determinable amount of compensated personal absence, or pay in lieu thereof.

\* - *Included in CAS 402*



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# CAS 408 – Fundamental Requirement

- Cost of compensated personal absence:
  - Shall be assigned to the cost accounting period or periods in which the entitlement was earned, and
  - For an entire cost accounting period shall be allocated pro-rata on an annual basis among the final cost objectives of that period.

# CAS 408 – Techniques for Application

- Determinations – each plan is separate
- Measurement – when is entitlement earned
- Determination of employer’s liability – include all that exists and adjust for anticipated non-utilization
- Adjustments:
  - Start with the employer’s liability for the cost accounting period
  - Adjust for changes
  - Reduce for excess at the close of the cost accounting period
- Allocations – allocate pro-rate to total of allocation base for the cost accounting period.

## Polling Question #2

What are the compliant methods for assigning paid time off compensation expenses to a cost accounting period?

- When earned
- When taken
- It depends



# Fun Facts about CAS 408

- Does not apply to contracts and grants with state, local, and Federally recognized Indian Tribal Governments.
- Currently in process for alignment/conformance with GAAP:
  - Staff Discussion Paper – March 2019
  - Potential for elimination of CAS 408
  - 1<sup>st</sup> of four potential steps in CASB rulemaking process

# CAS 412

# History

- CAS 412 - Composition and Measurement of Pension Cost
  - Published September 24, 1975
  - Took effect on January 1, 1976
- Companion Standard with CAS 413 – CASB thought a single standard would be too large and complex
  - 412 – Measuring components of pension cost establishes bases for assignment of pension cost to:
    - Cost accounting periods, and
    - Cost objectives
  - 413 – Adjusting pension cost and assigning to cost accounting periods.



# CAS 412 – Measurement of Pension Costs

- Provide guidance for determining and measuring the components of pension cost.
- Establishes the basis on which pension costs shall be assigned to cost accounting periods.
- CAS 412 does not cover the cost of Employee Stock Ownership Plans (ESOPs) that meet the definition of a pension plan.

# CAS 412 - Definitions

- 25 separate definitions – all pension cost specific
- Selected definitions for this session:

**(4) Actuarial cost method** means a technique which uses actuarial assumptions to measure the present value of future pension benefits and pension plan administrative expenses, and which assigns the cost of such benefits and expenses to cost accounting periods. The actuarial cost method includes the asset valuation method used to determine the actuarial value of the assets of a pension plan.

**(10) Defined-benefit pension plan** means a pension plan in which the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits.

**(11) Defined-contribution pension plan** means a pension plan in which the contributions are established in advance and the benefits are determined thereby.

# CAS 412 – Fundamental Requirement

- Components of Pension Cost
  - For most defined-benefit pension plans:
    - (i) the normal cost of the period,
    - (ii) a part of any unfunded actuarial liability,
    - (iii) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and
    - (iv) an adjustment for any actuarial gains and losses.
  - For pay-as-you-go defined-benefit pension plans:
    - (i) The net amount of periodic benefits paid for that period, and
    - (ii) An amortization installment, including an interest equivalent on the unamortized settlement amount, attributable to amounts paid to irrevocably settle an obligation for periodic benefits due in current and future cost accounting periods.
  - For defined-contribution pension plans:
    - Net contribution required after taking into account dividends and other credits, where applicable.

# CAS 412 – Fundamental Requirement

- Measurement of Pension Cost
  - For most defined-benefit pension plans:
    - Immediate-gain actuarial cost method
    - Each actuarial assumption must be separately identified and represent best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations
    - Actuarial assumptions used in calculating the amount of an unfunded actuarial liability shall be the same as those used for other components of pension cost
  - Consideration of the CAS Pension Harmonization Rule

# CAS 412 – Fundamental Requirement

- Assignment of Pension Cost
  - Generally, the amount of pension cost computed for a cost accounting period is assignable only to that period.
  - For defined-benefit pension plans other than those accounted for under the pay-as-you-go cost method, the pension cost is assignable only if the sum of (1) the unamortized portions of assignable unfunded actuarial liability, and (2) the unassignable portions of unfunded actuarial liability separately identified and maintained equals the total unfunded actuarial liability.
- Allocation of pension cost
  - Pension costs assigned to a cost accounting period are allocable to intermediate and final cost objectives only if they meet the requirements for allocation in 412-50(d).
  - Pension costs not meeting these requirements may not be reassigned to any future cost accounting period.

# Polling Question #3

- Accounting for the cost of pensions includes requirements for both defined benefit and defined contribution plans
- True or False?





# Fun Facts about CAS 412

- Not much fun with the pension standards . . .
- What do Actuaries think CPA stands for?
- Significant accounting changes regarding pensions over time have made the pension standards extremely complex for defined-benefit pension plans

# CAS 413

# History

- CAS 413 – Adjustment and Allocation of Pension Cost
  - Published September 24, 1975
  - Promulgated effective March 10, 1978
- Companion Standard with CAS 413 – CASB thought a single standard would be too large and complex
- Plant Closure impacts
- CAS Harmonization

# CAS 413 – Adjustment and Allocation of Pension Cost

- Provides guidance for adjusting pension cost by measuring actuarial gains and losses and assigning such gains and losses to cost accounting periods
- Provides the bases for allocating pension cost to the segments of an organization

# CAS 413 - Definitions

- 21 separate definitions – all pension cost specific
- Selected definitions for this session:

(14) **Pension plan termination** means an event; i.e., plan amendment, in which either the pension plan ceases to exist and all benefits are settled by purchase of annuities or other means, or the trusteeship of the plan is assumed by the Pension Benefit Guarantee Corporation or other conservator. The plan may or may not be replaced by another plan.

(19) **Segment** means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority ownership, but over which it exercises control.

(20) **Segment closing** means that a segment has (i) been sold or ownership has been otherwise transferred, (ii) discontinued operations, or (iii) discontinued doing or actively seeking Government business under contracts subject to this Standard.

# CAS 413 – Fundamental Requirement

- Actuarial gains and losses:
  - must be calculated annually, and
  - assigned to the cost accounting period for which the actuarial valuation is made and subsequent periods
- The actuarial value of pension plan assets must take into account:
  - unrealized appreciation and depreciation, and
  - the accumulated value of permitted unfunded accruals
- Contractors must allocate pension costs to each segment having participants in a pension plan
  - Separate calculation of pension costs for a segment is generally required
  - In some circumstances, allocations may be made using a composite pension cost for two or more segments and allocating the cost to the segments by means of an allocation base
- The amount of pension cost assignable to a segment cannot exceed the sum of:
  - (i) The maximum tax-deductible amount computed for the plan as a whole, and
  - (ii) The accumulated value of prepayment credits not already allocated, apportioned among segments



# Fun Facts about CAS 413

- In the 1980's – some GovCon pensions were significantly overfunded
- Some contractors terminated plans to get access to excess funds
- Government wanted to recover its 'equitable share'
- Significant economic and GAAP issues
- Numerous court cases deal with closed segments, terminated plans and other adjustments

# CAS 415

# History

- CAS 415 – Cost of Deferred Compensation
  - Published July 30, 1976
  - Took effect on July 10, 1977

# CAS 415 – Cost of Deferred Compensation

- Provides criteria for the measurement of the cost of deferred compensation and the assignment to cost accounting periods.
- Not applicable to the:
  - Cost for compensated personal absence, and
  - Cost for pension plans that do not meet the definition of an Employee Stock Ownership Plan (ESOP)

# CAS 415 - Definitions

- **Deferred compensation** means an award made by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods prior to the date of the receipt of compensation by the employee. This definition shall not include the amount of year end accruals for salaries, wages, or bonuses that are to be paid within a reasonable period of time after the end of a cost accounting period.
- **Employee Stock Ownership Plan (ESOP)** means:
  - (i) An employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) of 1986 as a stock bonus plan, or combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock, and
  - (ii) Any other deferred compensation plan designed to invest primarily in the stock of the contractor's corporation including, but not limited to, plans covered by ERISA.
- **Fair value** means the amount that a seller would reasonably expect to receive in a current arm's length transaction between a willing buyer and a willing seller, other than a forced or liquidation sale.
- **Market value** means the current or prevailing price of a stock or other property as indicated by market quotations.

# CAS 415 – Fundamental Requirements

- The cost of deferred compensation must be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee.
- In the event no obligation is incurred prior to payment, the cost of deferred compensation shall be the amount paid and be assigned to the cost accounting period when the payment is made.
- Measurement of deferred compensation costs:
  - For deferred compensation other than ESOPs, the deferred compensation cost shall be the present value of the future benefits to be paid by the contractor.
  - For an ESOP, the deferred compensation cost shall be the amount contributed to the ESOP by the contractor.
- The cost of each deferred compensation award is considered separately for purposes of measurement and assignment to cost accounting periods.
- If the cost associated with employees covered by a deferred compensation plan can be measured and assigned with reasonable accuracy on a group basis, separate computations for each employee are not required.

# CAS 415 – Techniques for Application

- The contractor has incurred an obligation for the cost of deferred compensation when **all** of the following conditions have been met:
  1. There is a requirement to make the future payment(s) which the contractor cannot unilaterally avoid
  2. The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor
  3. The amount of the future payment can be measured with reasonable accuracy.
  4. The recipient of the award is known
  5. If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur
  6. For stock options, there must be a reasonable probability that the options ultimately will be exercised

# Polling Question #3

Accounting for pensions under CAS 412 & 413 include Employee Stock Ownership Plans (ESOPs)

- True
- False
- Need more information





# Fun Facts about CAS 415

- Prior to CAS 415 – costs were only allowable if deductible for income tax purposes – i.e. cash basis accounting
- DCAA history challenged ESOP interest costs – cost principles and legislation maintained the allowability of these costs
- Several court cases, *Ralph M. Parsons, Co.* and *Ball Corp.*
- Sept. 200 - CASB Staff Position Paper - CAS 412 or CAS 415
- *Pacific Architects and Engineers* – Completion bonuses payable upon completion of a full two-year tour of duty – not all 6 criteria met – the recipient not known until payment is made

**Positioning for future sessions . . .**

***September 14<sup>th</sup> – 2:00 Eastern . . .***

**Episode 5 – Direct and Indirect Costs – CAS 418**

Contact

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# Last Chance for Some Questions

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