March 15, 1999

Dr. Rein Abel

Director of Research

Cost Accounting Standards Board

Office of Federal Procurement Policy

725 17th Street, N.W., Room 9001
Washington, D. C. 20503

Attn: CASB Docket No. 96-02

Re: Funding of Post Retirement Benefit Costs, CASB Docket No. 96-02

Dear Dr. Abel:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section’s governing Council and substantive committees contain members representing these three segments, to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

The Cost Accounting Standards Board has requested further comment on whether there is a need to "substantiate" accruals of post-retirement benefit ("PRB") costs by funding, and what the appropriate prerequisites for accrual of PRB costs should be. As previously stated in our December 19, 1996 comments, the Section believes that accrual accounting is required by the CAS Board's statutory mandate to achieve uniformity and consistency in accounting for contract costs, and generally provides the best matching of costs to the production of goods and services that give rise to those costs. The Section's position continues to be that a valid accrual does not need to be substantiated through funding, whether we are talking about pension costs or PRB costs. Funding is a matter of procurement policy, not cost accounting.

Pursuant to generally accepted accounting principles ("GAAP"), liabilities are recorded on an accrual basis when there is a high probability (not absolute certainty) that a cost or loss has been incurred. For purposes of accruing the liability for PRBs, the terms of the written PRB plan and the employer’s past and present practice of providing PRBs to retirees are recognized under GAAP as requisite evidence that a valid liability has been incurred.

In the commercial business environment, employers compete for "the best and the brightest" employees. An employer works hard to earn the reputation of "an employer of choice" and makes significant investments in hiring and training its work force. Consequently, the responsible employer is not likely to abrogate its PRB plan or take other "employee unfriendly" actions to adversely affect its ability to retain its valuable work force. We believe that the CAS Board would find, if it researched the issue, that employers may amend PRB plans to contain cost growth but not to eliminate or reduce costs below the amounts recognized for financial or contract costing purposes. There is no evidence, so far as we know, that the Government has reimbursed contractors for costs which contractors have not incurred. Thus, the liability that is recorded for financial reporting purposes pursuant to Financial Accounting Standards Board Statement No. 106 ("FAS 106") could be accepted by the Cost Accounting Standards Board.
Nevertheless, we also recognize (as noted in our December 1996 letter) that the CAS Board has a unique mandate to ensure the accurate measurement, assignment, and allocation of contract costs. This means that although the Board should consider accounting rules promulgated by other bodies, on occasion there may be reasons, grounded in the Board’s charter, not to follow those rules. Financial accounting requires accruals for PRB costs because this produces a more conservative statement of financial results, benefiting those who invest in or lend to the company. It serves this purpose to require accruals even where payment of the liability may not be legally required, so long as it is probable. In contrast, the ability of the beneficiary to compel payment has been used for government contract costing purposes in the past as a determinant of the validity of the liability, and thus as a threshold requirement for accrual. Our previous comments recognized this to be a reasonable limitation on the accrual of PRB costs. In view of the fact that contractors are most likely to scale back benefits to contain cost growth, rather than reduce the level of cost or eliminate benefits altogether, it would not be reasonable to require that the present level of benefits be compellable indefinitely. Some other compellability test, if one can be articulated, would be more appropriate.

In summary, the Section is of the opinion that funding is not required to substantiate the validity of an employer’s PRB obligation. We believe the Board may accept the liability recorded under FAS 106, or may require some form of compellability.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

David A. Churchill
Chair, Section of Public Contract Law

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