



DEFENSE CONTRACT MANAGEMENT AGENCY

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December 15, 2008

Cost Accounting Standards Board
Attention: Raymond Wong
Office of Federal Procurement Policy
725 17th Street, NW, Room 9013
Washington, DC 20503

Dear Mr. Shipley:

We are providing our comments to the Cost Accounting Standards Board's (CASB) Advance Notice of Proposed Rulemaking (ANPR) posted in the Federal Register on September 2, 2008. The CASB drafted the ANPR in response to the Pension Protection Act's (PPA) requirement for the CASB to harmonize the CAS 412 and 413 rules with the PPA's minimum funding requirements by January 1, 2010. The PPA's minimum funding requirements are generally based upon amounts to settle the pension plan obligations. We appreciate the extension to December 15, 2008 granted by the CASB for public comments.

The proposed revisions to CAS 412 and 413 change the fundamental cost accounting approach used to measure and assign pension cost. The current CAS 412 and 413 measure and assign pension cost using the "contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations of pension plan performance." The supplementary information in ANPR refers to the current rules as the "going concern approach."

The ANPR retains the "going concern approach" to measure the minimum amount of pension cost for a given accounting period. However, the ANPR requires an adjustment to the "going concern" amounts when either the cost of settling the pension obligation or the PPA minimum funding amount is higher than the "going concern" amount. The ANPR refers to cost of settling the pension obligation as the "settlement or liquidation approach."

The ANPR is therefore a hybrid of these two fundamentally different accounting approaches. As a result, we anticipate that applying the ANPR will both increase the complexity of the contractor's yearly actuarial calculation of pension cost and the amount of pension cost on Government contracts.

To limit the amount of the pension cost charged to Government contracts, the ANPR provides a limitation to the amount of annual pension costs. The limit is "125 percent of the actuarial accrued liability, without regard to the minimum actuarial liability, plus the current normal cost over the actuarial value of the assets." We agree with this limitation because it

affords some protection against the volatility caused by using the “settlement or liquidation approach.”

We appreciate the opportunity to recommend changes to the proposed rule. We trust that the CASB considers our comments to simplify the rule, enhance the predictability of CAS pension cost and clarify certain parts of the rule. Our comments are as follows:

Simplify the Rule.

Components of Pension Cost. CAS 412 identifies four components of pension cost. The proposed CAS 412 rule adjusts the components of pension cost when the “settlement or liquidation approach” amount exceeds the “going concern” amount. The adjustments are as follows:

1. Actuarial loss. A new amortization amount referred to as the “liability adjustment amount” is created when the minimum actuarial liability exceeds the actuarial accrued liability. The “liability adjustment amount” is added to or included in the calculation of actuarial losses that is amortized a 10 year period as illustrated by CAS 412-60(c)(2).
2. Mandatory Prepayment Credits. When the minimum funding amount under PPA exceeds the CAS pension cost, the excess is accounted for as a “Mandatory Prepayment Credit.” The Mandatory Prepayment Credit is amortized as an additional cost in equal annual installments over 5 years (with interest).
3. Normal Cost Adjustment. The normal cost is increased by a “normal cost adjustment” when the normal cost computed using the “settlement or liquidation approach” and assigned to the current accounting period.

The revised CAS rule creates two new amortization amounts (first two items) and a current year cost (the third item). To simplify the rule, we recommend that only the first and the third items be included in the revised rules. Our recommendation simplifies the rule by eliminating the complex accounting for Voluntary and Mandatory Prepayments, and the associated transition rules in CAS 412-60. In addition, using this approach assures that the amortization bases tie directly to the actuarial liability and will be in harmony with the CAS balance test (CAS 412-40(c)).

In the event that the CASB retains the “Mandatory Prepayment Credit” in the rule, we recommend that the rule be simplified. The method of recovering voluntary prepayment credits that have occurred before implementation of the CAS harmonization rule creates a challenge in forecasting cost for programs. The rule requires the contractor to identify voluntary and mandatory prepayment credits to the initial effective date of CAS 412. We recommend that the look back assessment be deleted from the rule.

CAS 413-50(c)(12) Adjustment. The CAS 413-50(c)(12) adjusts pension costs when a certain non-recurring events occur such as a curtailment of benefits or a segment closing. Though we agree with using the “settlement or liquidation approach” for the measurement of annual pension cost (because of the burden of the added funding requirements of PPA), we

believe that the “going concern approach” is the superior method of cost accounting for pension costs and should be generally retained for purposes of computing the CAS 413-50(c)(12) adjustment. We believe that the “going concern approach” provides the best measure of the funds needed by the pension trust to pay pension benefits absent a settlement of the pension obligation. Our experience shows that defense contractors only very rarely settle pension obligations. Therefore, we recommend that the use of the “going concern approach” when a segment has (i) been sold or ownership has been otherwise transferred, (ii) discontinued operations, or (iii) discontinued doing or actively seeking Government business). We note that if the contractor settles the pension obligation due to a segment closing, the current CAS rule permits the use of the “settlement or liquidation approach.” Also, we believe that using the “settlement or liquidation approach” for a curtailment of benefits is appropriate since the segment and Government contracts continue.

Enhance the Predictability of CAS Pension Cost.

The proposed CAS rule requires the minimum actuarial liability, adjusted normal cost and mandatory prepayment charge be measured using the “settlement or liquidation approach.” In these cases the “settlement or liquidation approach” utilizes an interest rate assumption either based upon rates of return high-quality fixed-income investments or rates of return of corporate bonds prescribed by the Secretary of the Treasury. The settlement rates are not the same as the long-term actuarial assumptions currently required by CAS 412, and are subject to change each year. In certain cases, we believe the changes will be significant over a relatively short time period of time. For example, the Moody’s yield on seasoned corporate bonds decreased by about 2 percent from 2000 to 2003. A 2 percent change would significantly increase the annual adjustments to the components of pension cost. As a result, the amount of the minimum actuarial liability, adjusted normal cost and mandatory prepayment charge may be difficult to estimate, and may likewise cause CAS pension cost to be difficult to predict when pricing contracts. As a result, we recommend that the interest rate used in the “settlement or liquidation approach” in the rule be an average of several years of rates published by the Secretary of Treasury in accordance with the PPA.

Clarifications to the Rule.

We recommend the following items be clarified:

1. The Requirements for an Equitable Adjustment.

The Transition Method at 9904.412.64.1 provides that the adjustment of the actuarial accrued liability, mandatory prepayment credit, and normal cost are phased in over a 5 year period. This adjustment will require an equitable adjustment when the standard becomes effective. While the equitable adjustment may be measured in year one, the actual adjustment would need to be made in each of the first five years (2011 through 2016). Some may argue that the contracting officer may be required to enter into a series of equitable adjustments for each change to the amortization period. This approach is overly burdensome to the contracting officers and may cause contract disputes. As a result, we recommend that the ANPR add language to clarify this important point, or remove these phase-in rules.

2. The Requirement for a CAS 413-50(c)(12) Adjustment.

The current and revised CAS rules require a CAS 413-50(c)(12) adjustment when certain events occurs such as a divestiture, curtailment of benefits, or pension plan termination. Over the history of a pension plan several events may occur, each requiring it's own CAS 413-50(c)(12). Some of the events may impact the pension plan in total such as a curtailment of benefits and termination. To clarify the cost accounting rules, we recommend an illustration be added to show the accounting of a curtailment of benefits followed years later by a termination or when the contractor discontinues doing business with the Government.

3. Terminology.

We recommend that the rule define the terms “current normal cost” (used in CAS 412-30 but used in definition of Assignable Cost Limitation), “minimum normal costs” and “normal cost for period.”

4. Illustrations.

The illustrations are difficult to evaluate because of the complexity of the rule and the fact patterns of each illustration. We recommend that one reference table be used for the actuarial information covered under one or more illustrations.

Please contact me at gerry.reichel@dcma.mil or 703 428-7607 if you would like to discuss our comments and recommendations.



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