July 9, 2010

Cost Accounting Standards Board
Attention: Raymond Wong
Office of Federal Procurement Policy
725 17th Street, NW, Room 9013
Washington, DC 20503
Via e-mail to casb2@omb.eop.gov

Reference: CAS Pension Harmonization NPRM, CAS-2007-02S

Dear Mr. Wong:

Members of the Aerospace Industries Association (AIA) and the National Defense Industrial Association (NDIA) thank the Cost Accounting Standards Board for recognizing the value of industry comments in the harmonizing of CAS 412 and 413 with the Pension Protection Act (PPA). We especially appreciate the CAS Board's acknowledgement of our thoroughness and consideration of the special concerns of contract cost accounting evidenced in our comments to the Advance Notice of Proposed Rulemaking (ANPRM). We have endeavored to provide the same qualities in our comments on the CAS Board's Notice of Proposed Rulemaking (NPRM) issued in the Federal register of May 10, 2010 that are included below and in the attachment to this letter.

We continue to be impressed with the quality of the CAS Board's efforts on harmonization. We recognize the considerable challenge and complexity these rules involve as well as the constraints on the timeframe in which the PPA required this rulemaking effort to be completed. We are supportive of the general approach to harmonization that the CAS Board continues to follow.

**Mechanisms for Harmonization Provided**
We strongly support several provisions of the NPRM which provide for fair and equitable harmonization. The use of the new liability measure, the minimum actuarial liability (MAL), in conjunction with the existing actuarial accrued liability (AAL) provides for a balanced liability measurement despite varying economic circumstances and is a reasonable balance between long and short term approaches. We believe the intention of using such an approach is to provide for timely recovery of PPA minimum required funding amounts as CAS pension cost, and we support this approach and intention. Our data modeling shows that for most pension plans, being able to use the higher of the liability measures to calculate CAS costs provides for earlier recovery of funding as pension cost. Timely recovery of CAS prepayment balances that grow as a result PPA funding requirements is a considerable concern for industry, as 75% of contractor's plans expect to have CAS prepayment balances at January 1, 2011 (see Illustration 3).

We also believe the change in amortization period for actuarial gains and losses from 15 to 10 years, while longer than the 7 year amortization period used for PPA, provides a reasonable

balance between timely cost recovery and an acceptable level of volatility for pension costs measured for CAS.

The CAS Board has retained the 5-year phase-in transition for recognition of pension costs produced by the new liability measure. We understand the transition rules are intended to mitigate any abrupt increase in costs as a result of the final rules to allow the Government to manage agency budgets. We continue to agree that this is an important reason to use such a transition and support the duration selected. In addition, we believe the phase-in will reduce the monetary amounts and number of equitable adjustments resulting from this required change in CAS, thereby lessening the opportunities for disagreements. Based on our data modeling, much of the increase related to the earlier recognition of the pension costs is delayed until 5-7 years after the year of applicability to a contractor, and these costs are likely to be recovered on contracts awarded subsequent to the final rule. As a point of reference, we included in our data survey the effects to CAS pension costs under the NPRM without any phased-in transition (see Illustration 3). Again we are supportive of retaining the 5-year phased-in transition, but we believe this data is meaningful evidence of industry's willingness to compromise by accepting a further delay in the timeliness of cost recovery and prolonged burden on our cash flow.

**NPRM Refinements Recommended**
In our review and data modeling of the NPRM, we have identified certain key areas of significant concern that we strongly believe must be refined prior to a final rule. These areas are described below with supporting details provided in the attachment to this letter. In addition to these concerns, we have provided comments in the attachment addressing various other provisions of the NPRM which although of lesser significance, may be useful to the CAS Board to consider in improving these rules.

**1. Trigger 1: Minimum Required Funding Compared with CAS Cost**

The NPRM introduces a new trigger mechanism that must be met for a contractor to use the harmonized rule. The first trigger in the mechanism is particularly troubling to us. Trigger 1 requires the comparison in each cost accounting period of the minimum required funding amount for PPA and the pension cost as calculated under the current CAS rules. However, using the minimum required funding as a trigger to enable use of the harmonization features of the rule effectively defeats the very harmonization mandated by Congress and that the objective the CAS Board intends to achieve. We believe this condition to be an unintended consequence, but the significant detrimental effects of this trigger were apparent to all contractors during data modeling of the NPRM, regardless of plan size, funding levels, when PPA became/becomes applicable, or any other factor. We strongly recommend elimination of Trigger 1.

The CAS Board indicated in the preamble to both the ANPRM and NPRM that providing full recognition of the minimum required funding amount for PPA as CAS cost in the year in which the contribution is made is unacceptable. Instead, the CAS Board chose an approach to spread the recovery of that contribution over a period that would balance timely cost recovery and volatility. Not only do we accept that approach, we support it as reasonable and necessary given the business realities of Government contracting. Unfortunately, the use of the first trigger is not only contradictory to this approach, but introduces the very PPA volatility that the CAS Board seeks to avoid.

The first issue we identified with trigger 1 relates to accessing the harmonized rule to achieve timely cost recovery. It is inevitable that in each year the minimum required funding amount exceeds the CAS cost a contractor will recover only a partial amount of that funding through the harmonized rule since the approach of the NPRM spreads recovery over a longer future period. The remainder of the funding will be a CAS prepayment. In each successive year the contractor must continue to have a minimum required funding amount in excess of the CAS cost as

currently measured to continue using the harmonized rule, however in each of these years only a portion of the amount funded in that year can be recovered. Eventually, usually shortly after the 7-year period in which a contractor is required under PPA to have funded 100% of the liability, the minimum required contributions will likely be less than the CAS cost. This means that PPA funding amounts recorded as CAS prepayments and not yet recovered under the harmonized rule are effectively excluded from timely recovery because the contractor can no longer use the harmonization features in the rule. The likelihood of significant and sustained balances of essentially unrecoverable CAS prepayments could encourage contractor termination of defined benefit pension plans to avoid the negative cash flow. Also, while we acknowledge the need and support the phased-in transition, it exacerbates this problem, causing even greater amounts of funding in the first five years to be recorded as CAS prepayments that become excluded from timely cost recovery. Those contractors who have been funding under PPA and have considerable CAS prepayment balances would find their timely recovery of those funds worsened by the trigger. Using a trigger isolated to a single cost accounting period as the key to using the harmonized rule in combination with a harmonized rule explicitly intended to recover costs over multiple cost accounting periods is ineffective in achieving harmonization.

The second issue we identified with trigger 1 relates to volatility. The minimum required funding calculation for PPA relies on a measurement of the pension assets within 10 percent of market value. This close tie to the market value subjects the funding measurement to considerable volatility, which is why the CAS Board has previously rejected an approach to harmonization that would set CAS cost equal to PPA minimum required funding or would link pension asset measurements closer to market value than current CAS (within 20 percent of market value). We agree with the CAS Board that the volatility of either of these is unacceptable for contract cost accounting. Relying on the funding amount as a trigger would also introduce an unacceptable amount of volatility into the measurement of CAS pension cost. The PPA funding calculation is significantly volatile by its nature because it is a snapshot at a single point in time with assets marked closely to market. Using the minimum required contribution as a trigger in the CAS rule means that those challenging future asset predictions for PPA funding now become part of forward pricing rate calculations because they determine which CAS measurement, current or harmonized, contractors must use to calculate the pension costs. Such asset value predictions would be fraught with opportunities for disagreements during audit. An incorrect prediction in the comparison of PPA funding required to CAS cost could result in an abrupt shift in the amount of actual CAS cost. The trigger would create the same problem as pension plans coming in and out of full funding—abrupt, significant, and difficult to predict changes in costs. Given that PPA requires funding be maintained at 100 percent of the liability, the PPA minimum funding calculation will always be close to the tipping point and small movements in the market asset values at the annual measurement date are likely to determine whether a funding contribution is needed or not. Just like the full funding limits in CAS have created havoc on predictability of pension costs for plans on the brink of full funding, using the PPA minimum required funding amount as a trigger would almost ensure volatility.

We worked with Towers Watson to support us in gathering contractor data estimates to develop a practical assessment of our concerns. Towers Watson, formed by the merger of Watson Wyatt and Towers Perrin, is a well known human resources consulting firm providing many companies actuarial services related to pensions. Eleven contractors participated in this survey, including both those with and without the deferral of PPA funding requirements. Seven of the survey participants are in the top 25 Department of Defense contractors for 2010. Many of the top 100 contractors do not have defined benefit pension plans, so we believe our participants represent a significant portion of the contractors subject to CAS 412 and 413. We gathered data on the effect of trigger 1 on the timely recovery of funding, using the relative balance of CAS prepayments due to PPA minimum funding required as our measure (i.e. funding amounts unrecovered would be recorded as CAS prepayments). Based on the survey (refer to

Illustration 3), the NPRM is currently written, including trigger 1, after 10 years of applicability results in 71% of PPA minimum required funding unrecovered as CAS pension cost and languishing as CAS prepayments. This demonstrates the proposed rule is substantially ineffective in achieving harmonization to provide for timely cost recovery of PPA minimum funding. By comparison, if trigger 1 was eliminated only 33% of the PPA minimum required funding remains unrecovered as CAS pension cost after the initial ten years of applicability. Without trigger 1, the timeliness of cost recovery, while not perfect, is significantly improved and generally acceptable to be considered harmonized. As a general observation by survey participants during their independent data modeling, the elimination of trigger 1 has a minimal effect on the amount of costs recovered during the early years of applicability because the contractors generally are using the harmonized rule as they fund towards the 100% of the liability ("full funding") required by PPA. However, after that period (about 7 years after applicability) there would be progressively declining cost recovery (i.e., lower cost recovery amounts year over year) of the PPA funding amounts recorded earlier as CAS prepayments. The data survey in Illustration 3 includes a comparison of the relative measure of CAS costs under the NPRM as written (with trigger 1) and the NPRM without trigger 1. It is readily apparent that the difference in cost recovery (with or without trigger 1) during the transition years is minimal, as we expected. However, the effects on cost recovery in the subsequent years of the survey is markedly different, providing for sustained recovery of the CAS prepayment balances built during the period of significant funding for PPA requirements. The elimination of trigger 1 modestly increases the peak amount of cost recovery reached in year six relative to current CAS, but we believe this to be manageable. In addition, while the CAS Board may feel a temptation to explore a longer transition period as an alternative, we caution the Board from such a direction, as limited industry data modeling of longer transition periods showed even greater increases in the peak years of cost recovery amounts.

The CAS Board may believe trigger 1 is necessary to limit cost recovery to reasonable amounts, however the NPRM includes several features specifically designed to address such concerns. Pension costs still cannot be recovered unless they are funded. The assignable cost limit of 100% prevents the build up of assets and recovery of excessive cost. The 5-year phased-in transition rule limits cost recovery in the early years of applicability to mitigate abrupt cost increases. Furthermore, the data survey shown in Illustration 3 comparing relative cost recovery under the NPRM as written with the NPRM without trigger 1 demonstrates that cost recovery is limited to reasonable amounts without trigger 1.

Illustration 1 demonstrates the detrimental consequences that result from restricting access to the harmonized rule to only those years in which PPA minimum required funding amounts exceed CAS cost, and Illustration 2 demonstrates the benefit of the elimination of trigger 1. We strongly recommend eliminating the first trigger from the rule and have provided specific recommendations for revisions to the language in the attachment in the section labeled CAS 412-50(b)(7).

**2. Harmonization for Segment Closing Adjustments**

The NPRM retains the current CAS calculations for segment closing adjustments, which uses the long term AAL measure of the pension liability. The CAS Board offers that using the long term AAL is the best measure of the funds needed by the pension trust to pay the future pension benefits at the time of the segment closing without essentially a liquidation of the pension plan. We respectfully offer a different viewpoint. A segment closing is not about the future of the plan; it is about the history of the plan as of the date of the segment closing. CAS 413-50(c)(12) effectively defines a segment closing adjustment as "an adjustment of previously-determined pension costs" and states that the segment closing adjustment calculation is "irrespective of whether or not the pension plan is terminated". Essentially, the adjustment is a truing up of the costs the Government has shared in as of the segment closing date. Given the

harmonized rule's reliance on the MAL for measuring pension cost, we believe the MAL is a better measure of the current value of the liability for the segment closing adjustment calculation. The MAL is a short term liability measure focused on current circumstances, while the AAL uses assumptions about future conditions over a long period of time.

A segment closing adjustment is of previously-determined pension costs, and the MAL is the liability measure most, if not all, contractors will rely on with the new harmonized CAS rule to calculate their pension costs. The use of the MAL in the harmonized rule is intended to allow contractors to achieve earlier recognition of pension costs in harmony with the earlier funding requirements of PPA. If CAS continues to use the AAL for segment closing adjustment calculations, a contractor would have to return to the Government the cost recognized under the harmonized rule. Thus, the harmonization of CAS would effectively be a loan instead of a reality. Refunds due to the Government would have to be from the contractor's operating cash flow because they could not be withdrawn from the pension trust, so the contractor would pay twice for the same pension costs—once to fund the trust and again in the form of a segment closing adjustment to the Government. We do not believe any of this is the intended outcome of the CAS Board's harmonization efforts.

There is also another potential unintended consequence the CAS Board should consider. If segment closing adjustments continue to be based on the AAL after the final harmonized rule is issued, contractors could be incented to terminate plans to recover costs rather than closing the segment and owing cash to the Government to refund costs recovered under the harmonized rule. Such plan terminations would result in greater costs charged to government contracts than the MAL would provide for in segment closing adjustments.

We highly recommend replacement of the AAL with the MAL as the liability measurement used for segment closing adjustments. We have also provided specific recommendations for revisions to the language in the attachment in the section labeled CAS 413-50(c)(12).

**3. Effective Date of Final Rule**

As the rulemaking process continues, contractors are considering the practical issues associated with implementation of these rules, such as the timing of incorporating the new rule into forward pricing rates. The NPRM indicates that the final rules are effective immediately upon publication in the Federal Register (CAS 412-63(a), CAS 413-63(a)). Given the complexity of the calculations under CAS 412 and 413, we strongly recommend a 60 day delay in the effective date of the final rule from the date of publication in the Federal Register. This will allow contractors time to incorporate the new rule into their forward pricing rates and ensure any new contract awards after the effective date are priced appropriately. The regulations presume that any contract awarded after the effective date is priced under new CAS for performance periods after the applicability date for the contractor, so no equitable adjustment would be necessary. If the final rule is effective immediately upon publication in the Federal Register, new contract awards will be priced under existing CAS since there would not be time to incorporate the new rates, yet they do not appear to be entitled to an equitable adjustment. CAS 9903.305(e) provides for delays in effective date up to 120 days after publication of the final rule in the Federal Register, and this provision has been used before, as evidenced in CAS (e.g., CAS 404-63 Final rule published 2/13/96, effective 4/15/96; CAS 409-63 Final rule published 2/13/96, effective 4/15/96; CAS 415-63 Final rule published 5/1/2008, effective 6/2/2008). Given the complexity of the calculations under CAS 412 and 413, we believe a delay in the effective date is warranted.

**Additional Opportunities for Public Comment**

While we encourage timely completion of the revised rules, we believe it is equally important the final rule achieves effective harmonization rather than a rushed and perhaps flawed rule. Since

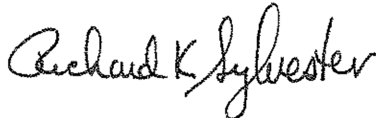
substantive refinements are necessary to the NPRM to achieve effective harmonization, we recommend the CAS Board consider issuing another NPRM before proceeding to a final rule.

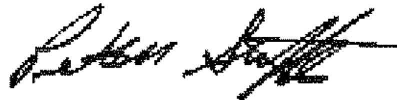
Given the complexities involved in these rules, it would be desirable for all interested parties to review revisions and provide the CAS Board insight into the clarity of the proposed language by those responsible for the practical application of the rules. This action would alert the CAS Board to any unintended consequences identified through extensive data modeling of the proposed rule before the final rule is issued. We believe it would be beneficial to all parties, if the CAS Board issues a final rule that is essentially unchanged from the NPRM that precedes it.

The timing of applicability may not be affected by issuing another NPRM. because even if the final rule is published in 2010, it is highly likely to be so close to the end of the year that most contractors will not receive a new contract to trigger applicability until 2012 anyway.

**Conclusion**
The CAS Board continues to make progress in reaching a final harmonized rule, and only a few refinements are necessary to this NPRM. The comprehensive comments by CAS subsection are included in the attachment. Thank you for the opportunity to support the Board in this important undertaking. We look forward to additional opportunities in the future. If you have any questions or need additional information, please contact Dick Powers of AIA at (703) 358-1042 or at dick.powers@aia-aerospace.org or Ruth Franklin of NDIA at (703) 247-2598 or at rfranklin@ndia.org.

Sincerely,





Richard K. Sylvester
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Enclosure

## Detailed comments by CAS subsection

1. **CAS 412-30(a)(9)** As we understand the calculations of CAS 412-50(b)(7), the assignable cost limitation would be calculated using whichever liability measure (i.e., AAL or MAL) was used in determining the pension cost for the period. We believe the definition of assignable cost limit should be revised to clearly reflect this. We recommend that the definition read, "Assignable cost limitation means the excess, if any, of the actuarial accrued liability plus the normal cost for the current period (or the sum of the adjusted actuarial accrued liability and adjusted normal cost if pension costs for the period are measured under CAS 412-50(b)(7)(i)) over the actuarial value of the assets of the pension plan."

2. **CAS 412-50(a)(1)(v)** The third sentence in this section reads, "The change in the unfunded actuarial liability attributable to the liability adjustment amount computed in accordance with 9904.412-50(b)(7)(i)(A), *including a liability adjustment amount of zero if the provisions of 9904.412-50(b)(7) do not apply for the period*, shall be identified and included in the actuarial gain or loss established in accordance with 9904.412-50(a)(1)(v) and 9904.413-50(a)(1) and (2) and amortized accordingly." [Emphasis added] We believe the italicized clause means that if pension cost for the period does not rely on the minimum actuarial liability and minimum normal cost, there is no adjustment recognized for amortization. If this is the intent of the clause, we recommend an improvement to the language for clarity would be to eliminate that clause from the existing sentence in the NPRM and add a new sentence after the sentence referred to that reads, "If the provisions of 9904.412-50(b)(7) do not apply for the period, no liability adjustment is made."

3. **CAS 412-50(b)(7)** The use of a minimum required funding amount in excess of CAS cost as a gateway to access the harmonized rule thwarts effective harmonization. Since the approach of the CAS Board is to spread recognition of each of the funding amounts over a number of future years to smooth the cost impacts and mitigate volatility, a contractor would need access to the harmonized rule for all years in which those amounts are spread. However, a trigger which isolates access to the harmonized rule in only the first year when the funding occurs prevents the rest of the recovery of that funding as CAS pension costs in future years. Illustration 1 included with this letter demonstrates our concerns. We believe this result to be an unintended consequence and strongly recommend the following revisions. In the initial paragraph of this section reads, "For qualified defined benefit pension plans *in any period that the minimum required amount, measured for the plan as a whole, exceeds the pension cost, measured for the plan as a whole and limited in accordance with 9904.412-50(c)(2)(i), then* the actuarial accrued liability and normal cost are subject to adjustment in accordance with the provisions of paragraph (b)(7)(i) of this section, and the measured cost shall be adjusted if the criteria of paragraph (b)(7) (ii) of this section are met."[Emphasis added, and note that reference should be to 9904.412-50(c)(2)(ii) rather than (i)] We recommend the language shown italicized here be deleted, so the paragraph reads, "For qualified defined benefit pension plans, the actuarial accrued liability and normal cost are subject to adjustment in accordance with the provisions of paragraph (b)(7)(i) of this section, and the measured cost shall be adjusted if the criteria of paragraph (b)(7) (ii) of this section are met." In addition, we recommend the subsection 412-50(b)(7)(iii)(C) defining "Minimum Required Amount" be deleted because it is no longer necessary due to the first revision recommended to this section.

4. **CAS 412-60(c)(2)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We believe a simple revision to the sentence added in the NPRM for harmonization could be made. We recommend revising the sentence to read, "The pension cost for the period did not require adjustment of the actuarial accrued liability and normal cost in accordance with 9904.412-50(b)(7)."

5. **CAS 412-60.1(a)(2)(iii)** This subsection includes a reference to 9904.412-40(b)(4). However, this must be a typographical error since there is no such subsection. We recommend revising the reference to be 9904.412-40(b)(2).

6. **CAS 412-60.1(a)(2)(iv)(B)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend the last sentence in this subsection be deleted. That sentence reads, "This actuarial value of assets may be used to determine the minimum required amount since that amount is measured in accordance with ERISA rather than CAS 412 and 413."

7. **CAS 412-60.1(b)(2) Table 6** The table included in the red line version of the NPRM indicates that the minimum actuarial liability for the total plan is $ 5,557,000. However, the amount should be $15,557,000. In addition, the word "cost" is omitted in error at the end of "Expense Load on Normal" in the red line version of the table. The proposed rule as published in the Federal Register does not include the same typographic errors, though we wanted to identify this to ensure it is not inadvertently carried forward into the rule-making process.

8. **CAS 412-60.1(b)(3)(ii)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend deleting from the first sentence "In accordance with 9904.412-50(b)(7)(iii)(C)..." We also recommend deleting from the third sentence, "in accordance with 9904.413-50(c)(7).

9. **CAS 412-60.1(b)(3)(ii) Table 8** The table included in the red line version of the NPRM indicates that the Expense Load on Target Normal Cost is $2,000. However, the amount should be $82,000. The proposed rule as published in the Federal Register does not include the same typographic errors, though we wanted to identify this to ensure it is not inadvertently carried forward into the rule-making process.

10. **CAS 412-60.1(b)(4)(ii) Table 11** For clarity, we recommend you add a reference to see Table 5 onto Note 1.

11. **CAS 412-60.1(b)(5)(i)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend you eliminate subsection (A) Harmonization Threshold Test and (B) which describes the result of the test. The subsequent sections would be re-numbered accordingly.

12. **CAS 412-60.1(b)(5)(ii)(A)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend deleting the (i) from the reference to 9904.412-50(b)(7)(i).

13. **CAS 412-60.1(b)(6)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend deleting the (ii) from the reference to 9904.412-50(b)(7)(ii).

14. **CAS 412-60.1(b)(6)(ii) Table 15** For clarity, we recommend you add a reference to see Table 6 onto Note 2.

15. **CAS 412-60.1(c)(2)(i) Table 18** This illustration table's Notes require revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend deleting the "(i) and (ii)" from the reference to "9904.412-50(b)(7)(i) and (ii)" in Note 2, 3 and 4, so they reference only 9904.412-50(b)(7).

16. **CAS 412-60.1(c)(3)(i) Table 19** Notes 1 and 3 includes a reference to 9904.412-50(c)(2)(ii). However, for clarity we recommend deleting the "(ii)" in both notes to revise the reference to 9904.412-50(c)(2).

17. **CAS 412-60.1(c)(3)(ii)** This subsection includes a reference to 9904.412-50(c)(2)(ii) regarding the tax-deductible limitation. However, we believe this the reference has a typographical error and should be revised to 9904.412-50(c)(2)(iii).

18. **CAS 412-60.1(d)(1)(iii)** The first sentence in this subsection contains the word "liquated", however we believe this may be a typographical error. We believe the intended word may be "liquidated".

19. **CAS 412-60.1(d)(1)(v) Table 23** We believe Note 4 has a typographical error. We recommend the word "contribution" be revised to "contribute".

20. **CAS 412-60.1(d)(2)(i)** In this subsection, we believe the final word of the last sentence should be the plural "segments" rather than the individual "segment".

21. **CAS 412-60.1(e)(2)(ii) Table 28** Note 3 requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend deleting the second sentence to remove the reference to the definition of "Minimum Required Amount" because we recommend the deletion of this definition from 9904.412-50(b)(7)(iii)(C).

22. **CAS 412-60.1(e)(2)(iii)** The first sentence of this subsection includes the phrase "cushion amount". The closing quotation marks are missing from the phrase.

23. **CAS 412-60.1(e)(3)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. We recommend eliminating the "(ii)" from the reference to 9904.412-50(b)(7)(ii).

24. **CAS 412-60.1(e),(f), and (g)** These illustration subsections require revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule. Accordingly, we recommend deleting subsection (e)(4) Harmonization Threshold Test. In addition, we recommend adding additional subsections in (e) for Measurement of Potentially Adjusted Pension Cost and Harmonization of Measured Pension Costs. This recommendation would bring (e) into the same format used for the earlier under-funded segment illustration and apply the remaining requirements of 412-50(b)(7). Subsections (f) and (g) would need to be entirely re-worked to also flow through the other requirements of 412-50(b)(7). We do believe an example for overfunded segments is valuable, and recommend the illustration be retained and re-worked to reflect the elimination of the comparison of the minimum required funding comparison with CAS pension cost to use the harmonized rule.

25. **CAS 412-60.1(h)(1)** We believe an illustration regarding the amortization of the change in liability basis is valuable. However, this illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS

pension cost to use the harmonized rule. We recommend the second sentence be revised by deleting the words "and compared the CAS measured costs to the minimum required amounts for the same period". We also recommend deleting the third sentence referencing Table 41 and Table 41. We recommend these deletions be replaced with a sentence that reads something like, "Assume that for the pension costs measured for 2015 through 2017, both 2016 and 2017 are adjusted pursuant to 9904.412-50(b)(7)."

26. **CAS 412-60.1(h)(3)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule and to be made consistent with our recommendation for 412-60.1(h)(1). Accordingly, we recommend that this subsection be revised to read, "For 2015, the actuarial accrued liability plus the normal cost measured in accordance with 9904.412 and 9904.413 equals or exceeds the minimum actuarial liability plus the minimum normal cost and no adjustment to the actuarial accrued liability and normal cost is required by 9904.412-50(b)(7). For 2016 and 2017, the contractor performs the test required by 9904.412-50(b)(7)(i), and for both of these years the total settlement liability exceeds the total long-term liability for the period and the actuarial accrued liability and normal cost must be adjusted. This results in an adjusted actuarial accrued liability of $2,194,000, an adjusted normal cost of $93,000, and an adjusted expense load of $8,840 for 2016; an adjusted actuarial accrued liability of $2,312,000, an adjusted normal cost of $100,500 and an adjusted expense load of $9,300 for 2017. Table 43 shows the measurement of the unfunded liability for 2015 through 2017."

27. **CAS 412-60.1(h)(3) Table 43** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule and to be made consistent with our recommendation for 412-60.1(h)(3). Accordingly, the Current Year Actuarial Liability Basis for 2017 should be revised to replace "AAL" with "MAL". In addition, the Actuarial Accrued Liability, Including Adjustment should be revised to show $2,312,000 as the amount for 2017, which will require the Unfunded Actuarial Liability (Actual) to be re-calculated as $417,514.

28. **CAS 412-60.1(h)(4) Table 44** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule and to be made consistent with our recommendation for 412-60.1(h)(3) Table 43. The amount shown for the Actual Unfunded Actuarial Liability for 2017 should be revised to be $417,514. In addition, the Actuarial Loss (Gain) for 2017 must be re-calculated as $30,695.

29. **CAS 412-60.1(h)(5)** This illustration subsection requires revision to be made consistent with our comment to eliminate the minimum required funding comparison with CAS pension cost to use the harmonized rule and to be made consistent with our recommendations for 412-60.1(h)(4) and Table 44. We recommend deleting the rest of the subsection after the first two sentences which address the 2016 change in basis. Since the liability basis for both 2016 and 2017 would both be the MAL, there is no need to address a change in basis between those years. However, we do recognize that the CAS Board may choose to revise the amounts in the example to achieve a second basis change between 2016 and 2017, in which case revised language addressing such a second change in basis would be necessary.

30. **CAS 412-63(a)** Given the complexity of CAS 412 and 413, it is likely to require contractors up to 60 days after publication of the final rule to calculate new pension costs and incorporate those costs into their forward pricing rates for periods of anticipated applicability. During the time these rates are being updated, any new contract awards would be priced using the previous CAS rules even if the period of performance was after the applicability date. Since it appears in the regulations that contracts awarded subsequent to the effective date of the rule are not entitled to equitable adjustment, it is imperative that contractors be given a reasonable

period to respond to the final rule in calculating new rates. Accordingly, we strongly recommend that the language in this subsection be revised to make the effective date of the rule 60 calendar days after publication of the final rule in the Federal Register. We note that CAS 9903.305(e) provides for a delay in the effective date for a final rule of up to 120 days after publication in the Federal Register, and recent updates to CAS 404, 409, and 415 all used effective dates delayed after publication of the final rules.

31. **CAS 412-63(c)** Consistent with our strong recommendation that the effective date of the final rule be delayed until 60 days after publication in the Federal Register, this subsection which includes the effective date would also need revision to be consistent with the effective date in CAS 412-63(a).

32. **CAS 412-64.1** Consistent with our strong recommendation that the segment closing adjustments in CAS 413-50(c)(12) be revised to rely on the MAL instead of the AAL, we recommend that the transition rules also be revised to exclude segment closing adjustments to be subject to the 5-year phased-in transition. We understand that the purpose of the transition rules is to provide for a gradual recognition of the higher amount of pension costs anticipated to be assignable as a result of this new rule, with full cost recovery under the new rule over time. However, if a segment closing occurs during the transition period, there is no future period during which to recover the segment's remaining costs limited by the transition rules. Thus, we recommend that for segment closings that occur during the transition period, the phased-in transition limitations should not apply. Accordingly, we recommend the first sentence in CAS 412.64.1 be revised to read, "Contractors that were subject to this standard prior to [DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER] shall recognize the change in cost accounting method over the initial 5-year period of applicability, determined in accordance with CAS 9904.412-63(c), as follows, except with regard to segment closing calculations pursuant to 9904.413-50(c)(12) to which these transition rules are not applicable."

33. **CAS 413-40(c)** This subsection contains requirements for the allocation of pension costs to segments. As currently written in the NPRM the technical correction language describes the calculation of pension costs for the segment level using current CAS only and does not incorporate the harmonized method. Our understanding is that the calculation of pension costs at the segment level, if required, would still have access to the harmonized rules. For clarity, we recommend revising the third sentence in the subsection to read, "When pension costs are separately computed for a segment or segments, the provisions of Cost Accounting Standard 9904.412 regarding the assignable cost limitation shall be based on the actuarial value of assets, actuarial accrued liability and normal cost (or the minimum actuarial liability and minimum normal cost if applicable under the provisions of CAS 412-50(b)(7)) for the segment or segments for purposes of such computations."

34. **CAS 413-40(c)** We understand the maximum tax-deductible amount computed plus the accumulated value of prepayment credits to be for the plan as a whole and apportioned among the segments. However, the new format introduced in the NPRM to break up these two elements into a (1) and a (2) seems confusing as written. As an improvement to clarity, we recommend revising the last sentence in this subsection to read, "In addition, for purposes of 9904.412-50(c)(2)(iii), the amount of pension cost assignable to a segment or segments shall not exceed, for the plan as a whole and apportioned among the segment(s), the sum of (1) the maximum tax-deductible amount computed plus (2) the accumulated value of prepayment credits."

35. **CAS 413-50(c)(12)** Our understanding of the purpose of a segment closing adjustment calculation is to bring the cumulative cost for the segment charged to Government contracts into alignment as of the date of the segment closing, an activity often referred to as a "true up" by accountants. This understanding is consistent with CAS 413-50(c)(12), which effectively

defines a segment closing adjustment as "an adjustment of previously-determined pension costs". Since the harmonized rule will provide for measurement of pension costs using the minimum actuarial liability (MAL), it follows that this measurement must be incorporated into segment closing calculations as well, rather than rely on the AAL as the NPRM is written. In addition, as a shorter term measure, the MAL is reflective of the facts and circumstances as of the segment closing date, which aligns with the purpose of the segment closing adjustment and with the short term market value of the assets used. The long term AAL, on the other hand, is a liability calculation designed to be smoothed over time and not representative of any particular point in time. We highly recommend that where the actuarial accrued liability measure is used for segment closing adjustment calculations in the NPRM it be replaced to use the minimum actuarial liability. This revision would require that the first paragraph in the subsection read, "If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the minimum actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether the pension plan is terminated. The difference between the market value of the assets and the minimum actuarial liability for the segment represents an adjustment of previously-determined pension costs." Similarly, a revision in (12)(i) is necessary, so it would read, "The determination of the minimum actuarial liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with those used in the measurement of pension costs as calculated using the minimum actuarial liability." Again in (12)(iii) a revision is necessary, so it would read in part, "The calculation of the difference between market value of the assets and the minimum actuarial liability shall be made as of the date of the event...." Finally in (12)(v) revisions are necessary, so it would read in part, "If a segment is closed due to a sale or other transfer of ownership to a successor in interest in the contracts of the segment and all of the pension plan assets and actuarial liabilities pertaining to the closed segment are transferred to the successor segment, then no adjustment amount pursuant to this paragraph (c)(12) is required. If only some of the pension plan assets and actuarial liabilities of the closed segment are transferred, then the adjustment amount required under this paragraph (c)(12) shall be determined based on the pension plan assets and minimum actuarial liabilities remaining with the contractor." A second acceptable alternative would be to use the approach of the ANPRM which revised (12)(i) to add "However, the actuarial accrued liability under the accrued benefit cost method shall not be less than the minimum actuarial liability." This alternative would bring into alignment the use of the AAL or MAL for the segment closing adjustment calculation with the use of the AAL or MAL for the pension cost calculation.

36. **CAS 413-60(c)(8)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In the fifth and seventh sentences of this illustration the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

37. **CAS 413-60(c)(9)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In the third and fifth sentences from the end of this illustration the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

38. **CAS 413-60(c)(14)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In the second and third sentences from the end of this illustration the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

39. **CAS 413-60(c)(15)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In the third sentence of this illustration the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

40. **CAS 413-60(c)(20)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In the fourth sentence of this illustration the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

41. **CAS 413-60(c)(21)** Consistent with our recommendation to replace the AAL with the MAL, revisions would be necessary to illustrations included in CAS 413 regarding the calculation of segment closing adjustments. In sixth, seventh, eighth, and ninth sentences of this illustration, as well as the last sentence, the words "actuarial accrued liability" would need to be replaced with the words "minimum actuarial liability".

42. **CAS 413-60(c)(26)** This illustration refers to the CAS calculations of pension costs in circumstances where for ERISA the contractor is required to cease benefit accruals. The language refers only to the actuarial accrued liability in the third, fourth and fifth sentences. In addition, the third and fourth sentences also refer to only the normal cost. We recommend revising these sentences to read, "If the written plan document provides that benefit accruals will automatically be retroactively reinstated when permitted by ERISA, the pension cost measured pursuant to CAS 412 for contract costing purposes shall continue to recognize the benefit accruals. Otherwise, the pension cost measured pursuant to CAS 412 will not recognize any benefit accruals until and unless the plan is subsequently amended to reinstate the accruals. Furthermore, the decrease in the actuarial liability will be measured as an actuarial gain and amortized in accordance with 9904.413-50(a)(2)."

43. **CAS 413-63(a)** Given the complexity of CAS 412 and 413, it is likely to require contractors up to 60 days after publication of the final rule to calculate new pension costs and incorporate those costs into their forward pricing rates for periods of anticipated applicability. During the time these rates are being updated, any new contract awards would be priced using the previous CAS rules even if the period of performance was after the applicability date. Since it appears in the regulations that contracts awarded subsequent to the effective date of the rule are not entitled to equitable adjustment, it is imperative that contractors be given a reasonable period to respond to the final rule in calculating new rates. Accordingly, we strongly recommend that the language in this subsection be revised to make the effective date of the rule 60 calendar days after publication of the final rule in the Federal Register. We note that CAS 9903.305(e) provides for a delay in the effective date for a final rule of up to 120 days after publication in the Federal Register, and recent updates to CAS 404, 409, and 415 all used effective dates delayed after publication of the final rules.

44. **CAS 413-63(c)** Consistent with our strong recommendation that the effective date of the final rule be delayed until 60 days after publication in the Federal Register, this subsection which includes the effective date would also need revision to be consistent with the effective date in CAS 413-63(a).

**Illustration 1: Trigger 1 detrimental effect on timely recovery of PPA funding**

| | PPA Req'd. Fund | Old CAS | Harm'd. CAS | Trigger 1 | Cost Used | CAS Prepayment Balance |
|---|---|---|---|---|---|---|
| Year 1 | $500 | $150 | $175 | Yes | $175 | $500-175=325 |
| Year 2 | $500 | $150 | $200 | Yes | $200 | $325+500-200=625 |
| Year 3 | $500 | $150 | $250 | Yes | $250 | $625+500-250=875 |
| Year 4 | $500 | $150 | $290 | Yes | $290 | $875+500-290=1,085 |
| Year 5 | $500 | $150 | $320 | Yes | $320 | $1,085+500-320=1,265 |
| Year 6 | $500 | $150 | $310 | Yes | $310 | $1,265+500-310=1,455 |
| Year 7 | $500 | $150 | $300 | Yes | $300 | $1,455+500-300=1,655 |
| Year 8 | 0 | $150 | $290 | No | $150 | $1,655-150=1,505 |
| Year 9 | 0 | $150 | $280 | No | $150 | $1,505-150=1,355 |
| Year 10 | 0 | $150 | $280 | No | $150 | $1,355-150=1,205 |

- After full funding reached for PPA (required within 7 years), cannot access harmonized CAS rule due to failure to meet Trigger 1
- No sustained timely recovery for PPA funding amounts, now trapped as CAS prepayments

**Illustration 2: Improvement to timely recovery of PPA funding with elimination of Trigger1**

| | PPA Req'd. Fund | Old CAS | Harm'd. CAS | Trigger 1 | Cost Used | CAS Prepayment Balance |
|---|---|---|---|---|---|---|
| Year 1 | $500 | $150 | $175 | N/A | $175 | $500-175=325 |
| Year 2 | $500 | $150 | $200 | N/A | $200 | $325+500-200=625 |
| Year 3 | $500 | $150 | $250 | N/A | $250 | $625+500-250=875 |
| Year 4 | $500 | $150 | $290 | N/A | $290 | $875+500-290=1,085 |
| Year 5 | $500 | $150 | $320 | N/A | $320 | $1,085+500-320=1,265 |
| Year 6 | $500 | $150 | $310 | N/A | $310 | $1,265+500-310=1,455 |
| Year 7 | $500 | $150 | $300 | N/A | $300 | $1,455+500-300=1,655 |
| Year 8 | 0 | $150 | $290 | N/A | $290 | $1,655-290=1,365 |
| Year 9 | 0 | $150 | $280 | N/A | $280 | $1,365-280=1,085 |
| Year 10 | 0 | $150 | $280 | N/A | $280 | $1,085-280=815 |

- Elimination of Trigger 1 allows sustained cost recovery of PPA funding amounts after full funding for PPA completed
- Significantly improved recovery of PPA funding sustained beyond PPA full funding

Illustration assumptions: PPA funding requirements begin in year 1 and contractor reaches full funding through even contributions in 7 years. CAS harmonized rule applicable in year 1 with 5-year phase-in. No CAS prepayment balance prior to year 1. Interest/return on CAS prepayments, market effects, and normal cost growth have been ignored for simplicity of the illustration.

Note: The illustrative cost recovery results would be worse for most contractors, who have been funding for PPA (many since 2008) and will have CAS prepayment balances prior to applicability of the harmonized rule. They will reach full funding for PPA earlier than year 7 of the harmonized rule and be limited to the old CAS cost recovery earlier. In addition, based on our data survey, which considered the complexities of other factors ignored for this illustration, the actual disparity in CAS prepayment balances after 10 years of applicability is more severe, with Trigger 1 resulting in 71% of prepayment balances still unrecovered after year 10 while without Trigger 1, only 33% of prepayment balances remain unrecovered See our comments related to Trigger 1 in the letter and Illustration 3 for more details.

**Illustration 3: Industry Data Survey (Facilitated by Towers Watson)**

For purposes of this survey, the following were assumed:

- The new CAS rule will be applicable in 2011. The choice of 2011 is merely for illustrative purposes and should not be construed as indicative of the preferred effective date of the survey respondents.

- Transitional mandatory CAS prepayment balances were calculated as CAS prepayment balance less total ERISA credit balance. Thus, the ERISA credit balances (cash contributions in excess of ERISA minimum requirements) represented CAS voluntary prepayments for the calculation.

**Information about the participants and their plans:**

1. Number of Government contractors: 11 companies

2. Number of defined benefit pension plans: 20 plans

3. Companies included 5 of the top 10 defense contractors; 5 others within the top 50; and all 11are in the top 100

Of the top 100 Government contractors, most do not have defined benefit pension plans. We believe participation of these 11 contractors to be substantial enough from which to support modeling conclusions.

**Mandatory CAS Prepayment balances at January 1, 2011:**

4. Fifteen of the 20 plans (75%) have mandatory CAS prepayment balances.

Mandatory CAS prepayment balances represent funding under ERISA/PPA into pension trusts in excess of CAS pension costs recovered on Government contracts. Harmonization is expected to ease the negative cash flow for contractors through timely cost recovery and over time reduce ERISA/PPA funding that is currently languishing as CAS prepayments.

**Harmonization values:**

5. Comparison of CAS cost as average ratio = CAS costs under new rule/CAS costs under existing rule:

| NPRM, as is: | | NPRM, without Trigger 1: | |
|---|---|---|---|
| Year 1 | 114% | Year 1 | 115% |
| Year 2 | 128% | Year 2 | 132% |
| Year 3 | 137% | Year 3 | 140% |
| Year 4 | 146% | Year 4 | 151% |
| Year 5 | 137% | Year 5 | 163% |
| Year 6 | 131% | Year 6 | 156% |
| Year 7 | 94% | Year 7 | 145% |
| Year 8 | 93% | Year 8 | 133% |
| Year 9 | 89% | Year 9 | 117% |
| Year 10 | 85% | Year 10 | 98% |

Percentages above 100 are representative of higher cost recovery under the harmonized rules than current CAS, while those below 100 represent a reversion to current CAS rules (those prior to harmonization). Under the NPRM, as is (with Trigger 1), access to the harmonized CAS rule is

eliminated for most plans by Year 7, generally after the period in which full funding for PPA must be achieved and at which point PPA funding requirements would drop precipitously causing the contractor to fail the Trigger 1 test. However, under the NPRM without Trigger 1, harmonization is extended for most plans through Year 10. Our recommendation to eliminate Trigger 1 provides for ongoing harmonization rather than a limited period of harmonization, and the gradual recognition of the increase in cost in the early years is nearly the same as for the NPRM as written.

**Illustration 3: Industry Data Survey (Facilitated by Towers Watson) Continued**

**Progress in Harmonization:**

6. Comparison of average ratio of mandatory CAS prepayments remaining:

| NPRM, as is: | | NPRM, without Trigger 1: | |
|---|---|---|---|
| Year 1 | 100% | Year 1 | 100% |
| Year 2 | 96% | Year 2 | 96% |
| Year 3 | 92% | Year 3 | 90% |
| Year 4 | 87% | Year 4 | 85% |
| Year 5 | 81% | Year 5 | 77% |
| Year 6 | 77% | Year 6 | 67% |
| Year 7 | 74% | Year 7 | 57% |
| Year 8 | 74% | Year 8 | 47% |
| Year 9 | 73% | Year 9 | 38% |
| Year 10 | 71% | Year 10 | 33% |

Year 1 starts with 100% of the mandatory CAS prepayments and each subsequent year measures the progress in reducing prepayments. Reduction of CAS prepayment balances is a key measure that ERISA/PPA funding is being recognized timely as CAS pension cost rather than recorded as CAS prepayments. Under the NPRM, as is (with Trigger 1), CAS prepayments steadily decline during the initial 6 years of applicability, but during the last 4 years they are relatively unchanged. At the end of Year 10, contractors still have 71% of their CAS prepayment balances unrecovered as cost. This poor result correlates with the data shown above in Harmonization values, where access to the harmonized CAS rule is eliminated for most plans after Year 6 which means mandatory CAS prepayments are no longer being reduced because the mechanism for doing so—using the harmonized rule—is denied. However, the NPRM without Trigger 1 continues to provide for a steady decline in CAS prepayments by extending harmonization for most plans through Year 10. At the end of Year 10, contractors have 33% of their CAS prepayment balances unrecovered as cost—a much improved result. This also correlates with the data shown above for Harmonization values. Our recommendation to eliminate Trigger 1 provides for ongoing harmonization rather than a limited period of harmonization, and the trend in reduction of the CAS prepayments in the early years is nearly the same as for the NPRM as written.

**Without 5-year phased-in transition**

7. Comparison of CAS cost as average ratio = CAS costs under new rule/CAS costs under existing rule:

| NPRM, as is, but without the 5-year phase-in transition: | |
|---|---|
| Year 1 | 167% |
| Year 2 | 159% |
| Year 3 | 152% |
| Year 4 | 145% |
| Year 5 | 124% |
| Year 6 | 118% |

| | |
|---|---|
| Year 7 | 89% |
| Year 8 | 91% |
| Year 9 | 87% |
| Year 10 | 84% |

While we strongly support the transition rules or their duration, we looked at the ratio trend of CAS cost recovery for the NPRM as written (including Trigger 1) but without a phased-in transition to ensure we understood the impacts. As shown above in Harmonization values, percentages above 100 are representative of higher cost recovery under the harmonized rules than current CAS, while those below 100 represent a reversion to current CAS rules (those prior to harmonization). Comparing this trend in cost recovery with those above in Harmonization values, it is readily apparent that the transition rules are effective in limiting the amount of cost that would otherwise be recognized under the harmonized rule in the initial years of applicability. Essentially, the overdue cost recovery of PPA funding is being further prolonged for contractors. However, this data trend is evidence of industry's willingness to compromise for our customer.