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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

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

Dear Mr. Wong:

We appreciate the opportunity the Cost Accounting Standards Board (CASB) has given us to provide these comments on the Notice of Proposed Rulemaking (NPRM) issued in the Federal Register on May 10, 2010. We recognize the magnitude of the effort required by the CASB to satisfy the Congressional mandate to harmonize CAS 412 and 413 with the Pension Protection Act (PPA). The content of the NPRM, similar to the ANPRM, demonstrates the efforts of the CASB to respond to and balance the various perspectives this harmonization effort must consider to achieve the purpose intended by Congress.

We understand that given the urgency of the mandate to harmonize CAS, the CASB has chosen an approach to make modifications to the existing CAS rules rather than undertake a complete overhaul of the rules. We understand and support this approach. In addition, we continue to support the CAS modifications to adopt the PPA-like minimum actuarial liability (MAL) and shorter 10-year amortization period for actuarial gains/losses in order to achieve harmonization. We also support the five year phase-in transition and believe it to be critical for the agencies in managing the resulting cost impacts. Our data modeling shows that the 5 year transition duration chosen by the CASB effectively balances timely recovery under the new rule with the amount of cost recognized during the peak year of the curve. We note these features introduced in the ANPRM have been retained in this NPRM. We recognize the NPRM to be a refinement to the ANPRM by the CASB and appreciate the lengthy explanations in the Federal Register notice that assisted us in understanding the approach of the CASB and analyzing the proposed rule in context to offer meaningful comments.

In reviewing the NPRM, we found that most of our concerns align with those of other government contractors and are reflected in the comprehensive letter submitted by the Aerospace Industries Association and co-signed by the National Defense Industrial Association. There are certain other areas we would like to take this opportunity to comment on, as well as emphasize those points made in the referenced industry association letter we support. We believe that with only a few refinements to the NPRM the CASB could consider harmonization complete.

CAS Harmonization

We believe harmonization will be achieved when the CAS rules provide that government contractors recover their PPA minimum required funding amounts within a reasonable period of time without the introduction of an undue amount of volatility that impairs the ability to develop accurate forward pricing rates—said simply, a fair and equitable balance between timely cost recovery and volatility is attained.

CAS prepayment balances are a measure of the disparity between the CAS and ERISA/PPA rules. ERISA/PPA requires earlier funding than can be recognized immediately as CAS pension cost. The "excess" funding is recorded as a CAS prepayment to be recovered as CAS pension cost in future years. The concern is how many years into the future a contractor must wait for cost recovery of that funding. We do not believe harmonization must necessarily bring CAS prepayment balances to zero to be deemed successful. CAS prepayment balances have been endured due to the divergence of CAS cost recovery and ERISA funding for nearly 20 years. The amendment of ERISA funding rules by PPA simply caused a wider divergence.

We expect the harmonized CAS rules to provide for earlier recognition of pension costs in amounts that return our CAS prepayment balance to a pre-PPA level within a reasonable period of time and provide for a gradual sustained decline of the CAS prepayment balance into future years. In other words, over a reasonable period of time, the CAS pension cost recognition needs to be re-aligned to lag behind PPA funding no worse than CAS previously lagged behind ERISA. This would ensure the wait to recover the remaining CAS prepayments as pension cost for government contracts is not substantially worse than it was prior to the PPA amendment to ERISA. We understand that what is a reasonable period of time for CAS to make up the lost ground in the disparity with ERISA/PPA is somewhat a matter of compromise. While waiting decades to recover CAS prepayments related to PPA funding under current CAS is certainly inequitable to contractors, given the current business conditions, we believe a remediation period of up to 15 years or so may be necessary to restore cost recovery to pre-PPA conditions.

Trigger 1: Comparison of PPA funding and CAS cost

We are puzzled by the CASB's decision to incorporate the PPA minimum required funding into CAS as the first trigger to enable use of the harmonized rule. We understand the CASB's approach is to recognize funding smoothed over a period of years into the future to eliminate the volatility inherent in PPA. Given this approach, it is inevitable that when a contractor satisfies the full funding requirement of PPA, the required funding amounts will drop precipitously and the harmonized CAS rule can no longer be used because this trigger is failed. Unfortunately, despite failing trigger 1 at this point, the contractor cannot have fully recovered previous years' PPA required funding amounts as CAS pension costs because the costs are spread over a number of years into the future rather than recognized in the single year when the funding occurs. The result is a significant accumulated balance of PPA funding amounts recorded as CAS prepayments that will take decades to recover as CAS pension costs under the NPRM as proposed.

Furthermore, we understand the CASB intends to avoid the introduction of undue volatility into the harmonized rule and demonstrated this in their earlier rejection of a direct adoption of PPA funding as the CAS pension cost measure. The CASB recognized that by tying both asset and liability measurements close to market PPA introduced significant volatility into the annual funding calculations, which is undesirable for government contract accounting. However, the use of the PPA required minimum funding as a trigger to access the harmonized rule effectively incorporates the volatility of that funding measurement into the CAS rule.

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We believe these results to be unintended consequences, but they are real consequences nevertheless that must be addressed before proceeding to a final rule. Our recommendation is the elimination of trigger 1 from the rule. Our data modeling shows little, if any, effect on cost recovery in the initial years of applicability with the elimination of trigger 1 because the MAL is already being used. However, cost recovery of PPA funding amounts through the use of the MAL is extended into later years although at progressively lower amounts.

Segment closings

Despite the harmonization of the CAS pension cost measurement, the NPRM does not include any mechanism for harmonization of segment closings. The prior ANPRM included a provision that while the AAL would be used to measure the liability, it could not be lower than the MAL for segment closing adjustments. This provided symmetry with the measurement of the previous pension costs which also used the higher of the AAL or MAL. This symmetry is necessary since a segment closing adjustment, according to CAS 413-50(c)(12), is "an adjustment of previously-determined pension costs".

The NPRM eliminated the harmonization for segment closings, instead reverting to the current CAS rules that use the AAL. Without a harmonization feature, such as the use of the MAL, adjustments resulting from the sole reliance on the AAL are likely to require contractors to refund the cumulative amount of pension costs recognized under the harmonization rule at the time of a segment closing. Essentially, the perspective of the proposed CAS 413 rule is that the earlier cost recognition under the MAL in the harmonized CAS 412 rule is too high, so the segment closing adjustment will re-set the cumulative cost amount to what would have been recognized as CAS pension cost had the AAL been used (i.e., as if no harmonization had occurred at all). Thus, the NPRM as proposed contains contradictory perspectives between ongoing cost recovery and settling up for segment closings.

Furthermore, those refunds of "excess" pension costs cannot be withdrawn from the pension trust, where they were funded as mandatory requirements of PPA. Instead, contractors would have to pay those refunds from operational cash flow.

We recommend that the CASB incorporate a harmonization feature for segment closings. We believe that either replacement of the AAL with the MAL or reversion to the language proposed in the ANPRM (i.e. the higher of the AAL or MAL) would be appropriate.

Effective Date of Final Rule

When the CASB publishes the final harmonized rule, we calculate new pension costs at our corporate office, allocate those costs to intermediate home offices, and update our forward pricing rates at each segment for periods after applicability. We expect the process of incorporating the new rule into forward pricing rates will require up to 60 days. Given the complex mathematics involved in this rule, we recommend the CASB defer the effective date of the final rule at least 60 days after the publication date to allow us time to react to the rule and ensure new contract awards subsequent to the effective date are priced correctly.

Exceptional Gain/Loss Events

We note that the CASB expresses interest in comments concerning whether gains/losses from exceptional events should be amortized over a longer period. We understand that by "exceptional", the CASB means "extreme" actuarial gains or losses created by market performance, which very infrequently occur. We believe the proposed NPRM retains effective smoothing mechanisms for gains and losses, so alternative rules for exceptional gains or losses are unnecessary.. In addition, we are concerned that a provision to use a longer amortization period for certain circumstances would undermine one of the features important to achieve harmonization with PPA.

Conclusion

We appreciate this opportunity to provide the CASB information we hope will be helpful in the harmonization of CAS 412 and 413 with PPA. We consider the nature of our comments to be substantive changes to the NPRM and highly encourage the CASB to publish another NPRM for public comment before proceeding to a final rule. We look forward to future opportunities to provide additional information that may be useful for the Board's success in this challenging task.

Sincerely,

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