Section of Public Contract Law
AMERICAN BAR ASSOCIATION

321 North Clark Street • Chicago, IL 60654-7598
(312) 988-5596 or (312) 988-5699 • Fax: (312) 988-6033
www.abanet.org

Writer's Address and Telephone

Gibson Dunn & Crutcher, LLP
1050 Connecticut Avenue, N.W., Suite 9081
Washington, D.C. 20036-5303
Ph: (202) 955-8536
Fax: (202) 530-9533
kmanos@gibsondunn.com

July 9, 2010

VIA EMAIL AND FACSIMILE

Mr. Raymond J. M. Wong
Cost Accounting Standards Board
Office of Federal Procurement Policy
725 17th Street, N.W., Room 9013
Washington, D.C. 20503
Email POC: casb2@omb.eop.gov

Re: Cost Accounting Standards: Harmonization of CAS 412 and 413 with the Pension Protection Act of 2006, 75 Fed. Reg. 25892 (May 10, 2010) (CAS Pension Harmonization NPRM)

Dear Mr. Wong:

On behalf of the Section of Public Contract Law ("Section") of the American Bar Association ("Association"), I am submitting comments on the above-referenced Notice of Proposed Rulemaking ("Proposed Rule"). The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.[1]

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 Association's House of

[1] The Honorable Thomas C. Wheeler, a member of the Section's Council, did not participate in the Section's consideration of these comments and abstained from the voting to approve and send this letter.

Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the Association.[2]

I. INTRODUCTION

The Proposed Rule at issue is the culmination of three years of activity prompted by the Pension Protection Act of 2006 ("PPA"). On July 3, 2007, the Cost Accounting Standards Board ("CASB") released a Staff Discussion Paper, CAS-2007-02S ("SDP"), regarding the harmonization of Cost Accounting Standards ("CAS") 412 and 413 with the PPA. 72 Fed. Reg. 36508. After requesting and receiving comments on the SDP, including comments submitted by the Section on September 4, 2007, the CASB published an Advance Notice of Proposed Rulemaking ("ANPRM") on September 2, 2008. 73 Fed. Reg. 51261. The CASB then released the Proposed Rule and requested public comment on May 10, 2010. 75 Fed. Reg. 25982.

The SDP, ANPRM, and Proposed Rule are responses to Congress's mandate in the PPA that the CASB revise the CAS to harmonize CAS with the PPA. The Section believes that the CASB has made significant steps to modify CAS 412 and 413 in a clear manner, with the limited exceptions noted below. For the reasons discussed herein, the Section believes that the Proposed Rule does not adequately achieve the PPA mandate that the CASB harmonize the cost accounting rules in CAS 412 and 413 with the PPA because of the extended time periods for phase-in, implementation, and amortization in the Proposed Rule.

Consistent with the Section's purpose, our comments focus on policy and legal issues. The comments do not discuss issues related exclusively to actuarial or other issues.

II. BACKGROUND

In 2006, Congress passed the PPA. The PPA amended the minimum funding requirements for, and the tax deductibility of contributions to, defined benefit pension plans under the Employee Retirement and Income Security Act of 1974 ("ERISA"). This created a disparity between the PPA minimum contribution requirements and CAS provisions for Government contract pension costing. Section 106 of the PPA requires the CASB to revise CAS 412 and 413 to harmonize CAS with the amended ERISA minimum required contribution.

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[2] This letter is available in pdf format at: *http://www.abanet.org/contract/regscomm/home.html* under the topic "Cost Accounting."

The Section believes that harmonization of the CAS cost accounting rules for pensions means that CAS 412 and 413 should contain government contract cost accounting requirements for defined benefit pension costs that agree, as closely as possible, to PPA funding requirements.[3] This requires, at a minimum, that CAS 412 and 413 create for contractors doing business with the Government an incentive to maintain defined benefit pension plans and the opportunity for revenue flows that permit the achievement of the funding goals set forth in the PPA that exist for businesses selling commercially.

III. COMMENTS

Recognizing that much effort has been put forth to accomplish the harmonization objective of the PPA, the Section offers further comments to improve the Proposed Rule. Although the Proposed Rule takes significant steps toward fulfilling the PPA mandate for harmonization, the Proposed Rule can be improved by taking additional steps to harmonize CAS with the PPA and implementing certain other changes to ensure clarity and to minimize disputes.

A. The CASB Has Not Fully Implemented the PPA's Mandate to Harmonize CAS With the PPA

Section 106 of the PPA requires the CASB to harmonize CAS 412 and 413 with the PPA. The Proposed Rule does not fully achieve this objective because it would create CAS rules that are inconsistent with the PPA. For example, the Proposed Rule includes time periods for amortization, phase-in, and implementation that delay contractor recognition of increased PPA costs for CAS purposes for numerous years. The Section recognizes that the amortization, phase-in, and implementation periods are included to address CASB concerns regarding the Government's ability to fund the expenditures needed for the CAS harmonization effort, but these concerns appear to be outside of the CASB's congressionally-mandated area of authority and, thus, are not proper factors for CASB consideration.

The Proposed Rule includes several provisions that significantly delay contractor recognition of increased PPA pension costs. First, the Proposed Rule includes a ten-year amortization period for actuarial gains and losses arising from differences between the PPA and CAS. *See* 75 Fed. Reg. at 25984. This means that, for a decade, contractors would be unable to fully recognize increased PPA

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[3] Harmonize and harmony mean agreement. *Webster's II New College Dictionary* (3d ed. 2005).

pension costs and receive revenue from the Government as a buyer of goods and services.

Second, the Proposed Rule includes a phase-in period of five years for recognizing these costs. This phase-in will occur at "20% per year, *i.e.*, 20% of the difference will be recognized the first year, 40% the next year, then 60%, 80%, and finally 100% beginning in the fifth year." 75 Fed. Reg. at 25985. The CASB explained that it included this provision "[t]o allow time for agency budgets to manage the possible increase in Government contract costs and to mitigate the impact on existing contracts for both the Government and contractors . . . ." *Id.*

Third, the Proposed Rule includes an implementation date that would depend on the effective date of the final rule, when the contractor receives a CAS covered contract after the effective date, and the beginning of the contractor's first accounting period after receipt of a contract subject to the rule. The Proposed Rule provides "[t]his Standard shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable [based on award after the Standard's effective date]." 75 Fed. Reg. at 26024.

Together, the time periods for amortization, phase-in, and implementation delay full contractor recognition of increased PPA costs for CAS purposes for at least 15 or more years. The result of these provisions will be significant gaps between CAS pension costs and the PPA funding requirements, gaps that do not exist for businesses selling commercially. These gaps will have detrimental cash flow and profit impacts on contractors because they will be required to fund shortfalls over a shorter period than they will be able to recover associated costs from the Government. This gap is even greater for those contractors that were not permitted to delay the PPA funding requirements and that may already be financing significant amounts for PPA funding in excess of recovery under current CAS requirements.

Ultimately, delaying recovery of PPA funding may dissuade contractors from maintaining defined benefit pension plans. Such an outcome is not consistent with the PPA and the goal of harmonizing the CAS with the PPA. Thus, these provisions of the Proposed Rule appear contrary to the PPA's mandate to implement CAS rules providing timely recognition of increased contractor pension costs resulting from the PPA.

Accordingly, the Proposed Rule does not achieve the PPA's mandate of CAS rules providing timely recognition of increased pension costs, nor does the Proposed Rule articulate a proper accounting related purpose for this shortcoming.

Instead, for justification for the delay in recognizing these costs for CAS purposes, the Proposed Rule relies only on matters outside its statutory purview.

The CASB's authority for establishing standards is made clear in a brief summary of the CASB legislative history. When the CASB was established anew in 1988 as part of the Office of Federal Procurement Policy Act Amendments of 1988 ("Act"), Congress granted the CASB exclusive authority to "make, promulgate, amend, and rescind cost accounting standards and interpretations thereof designed to achieve uniformity and consistency in the cost accounting standards governing measurement, assignment, and allocation of costs to contracts with the United States." Pub. L. No. 100-679 (Nov. 17, 1988); 41 U.S.C. § 422(f)(1). In addition, the Senate Committee on Governmental Affairs explained that the Act "assigns only allocability functions to the Board. Allowability and other similar policy issues will be addressed by the Administrator and the agencies outside the purview of the CAS Board." S. Rep. No. 424, at 14-16 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5687, 5701-3. Thus, Congress clearly intended that the CASB only have authority to promulgate *accounting rules*.

The Proposed Rule does not link these significant recognition delays in an accounting-related purpose; thus, it appears the CASB has exceeded its authority. Regarding the five-year phase-in period, the Proposed Rule notes only that this provision was included in the proposed rule "[t]o allow time for agency budgets to manage the possible increase in Government contract costs and to mitigate the impact on existing contracts for both the Government and contractors . . . ." 75 Fed. Reg. at 25985. These concerns relating to "agency budgets" and the potential impact on the Government and contractors are not accounting-related issues within the CASB's statutory mandate. By promulgating rules based on agency funding issues rather than accounting-related issues, the Proposed Rule appears to have exceeded the CASB's congressionally-granted authority.

The Section, therefore, respectfully suggests that the CASB eliminate, or reduce significantly, the various provisions in the Proposed Rule that delay contractor recognition of PPA costs. Such provisions of the Proposed Rule are inconsistent with the congressionally-mandated goal of harmonization and appear to address policy considerations outside of the CASB's accounting authority.

B. Other Comments

In addition, the Proposed Rule should implement certain other changes to ensure clarity and to minimize disputes.

1. The Proposed Rule Should Identify Required Accounting Changes

The Proposed Rule should identify the specific changes in contractor accounting practices that will result from the rule's implementation. Under the Federal Acquisition Regulation ("FAR"), contractors generally are entitled to an equitable adjustment resulting from a CAS change that increases their costs. 48 C.F.R. § 52.230-2. Absent clear guidance on what changes are required, disputes regarding entitlement to equitable adjustments are a certainty.

The Proposed Rule will require contractors to adopt new cost accounting practices, at least in the areas of measuring and assigning actuarial gains and losses. As a result, contractors rightfully will seek reimbursement from the Government for the cost impact of these government-directed changes. To avoid differing interpretations, disagreements, and, ultimately, disputes over exactly what changes in cost accounting practices the Proposed Rule requires, the Proposed Rule should explicitly identify these changes. This will provide certainty to the Government and contractors, thus improving the operation of the Proposed Rule and decreasing the likelihood of disputes.

2. The Proposed Rule Should Establish Values Resulting From ERISA or Financial Accounting Standard Valuation Methods as CAS Compliant Amounts

The Proposed Rule should provide that when ERISA or Financial Accounting Standard ("FAS") asset, liability, cost, or other values are to be used for CAS purposes, such values are per se CAS-compliant amounts. This will avoid unnecessary disputes with government auditors regarding whether these values are appropriate.

Under the Proposed Rule, contractors may use ERISA and FAS actuarial methods and valuation software for CAS purposes. Values resulting from application of ERISA and FAS methods are subject to strict rules and are audited and reviewed and reflected in contractor tax and financial accounting records. Values resulting from application of these methods, therefore, are verifiable. Accordingly, the Proposed Rule should be modified to state that values resulting from a valuation method provided by ERISA or FAS are CAS-compliant values. We believe this modification would promote fairness. As noted above, under the Proposed Rule, contractors may use an ERISA or FAS valuation method. Thus, it would be unfair to permit government auditors to subsequently question amounts resulting from these valuations.

IV. CONCLUSION

The Section appreciates that the CASB has undertaken efforts seeking to harmonize CAS with the PPA. These comments seek to identify several areas where the Section believes the Proposed Rule could benefit from further analysis. The Section respectfully requests that the CASB consider the issues identified in these comments in developing a proposed rule that, among other things, more closely reflects the PPA's mandate to the CASB.

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

Sincerely,

Karen L. Manos
Chair, Section of Public Contract Law

cc: Donald G. Featherstun
Carol N. Park Conroy
Mark D. Colley
David G. Ehrhart
Allan J. Joseph
John S. Pachter
Michael M. Mutek
Patricia A. Meagher
Council Members, Section of Public Contract Law
Chairs, Accounting Cost and Pricing Committee
Kara M. Sacilotto