July 9, 2010

Cost Accounting Standards Board
Attention: Mr. 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:

BAE Systems, Inc. appreciates the opportunity to comment on the Notice of Proposed Rulemaking (NPRM) as these new rules will have a very significant impact on our corporate cash flow. Clearly, the development of this NPRM was a difficult task for the Board as these rules must deal with the conflicting goals of harmonization and mitigating cost increases to the Government. The balancing of these two goals is by no means a simple proposition. We also recognize that this work was done without the benefit of cost recovery projections for defense contractors subject to these rules. Therefore, we have modeled the implications of the NPRM and identified some of its provisions that we believe fall short of reaching a reasonable balance of these two goals.

Since the Board did not have the benefit of this specific data as to the impact of the NPRM in advance of its issue, we hope that you consider these comments and those provided by the Aerospace Industries Association (AIA) and the National Defense Industrial Association (NDIA) when working to develop the final rule. This letter focuses on the issues we consider critical.

Critical Concerns

Our most important concerns with the NPRM include the gateways or triggers placed on the application of the minimum actuarial liability (MAL); the effective date and the segment closing rules. We also believe that the Board should take this opportunity to better define the application of these rules. Although the examples were very helpful, it would be beneficial to have illustrations of equitable adjustments and to address the application of prepayment credits which should be at planned funding dates and not the beginning of the year. The following sections address each of our critical concerns.

Gateway/Trigger

The condition that the minimum required contribution (MRC) must exceed the CAS pension cost in order for there to be any “harmonization” of the CAS pension cost is problematic. Although on the surface, this “gateway” appears to be a possible reasonable condition, it makes the calculation quite complex, subject to volatility, difficult to predict and stands in the way of harmonization. And while the elimination of this gateway does not lead to a fully harmonized result, it does move the results in that direction while continuing to exercise control over Government cost increases.

In a large part, the problem with this gateway is how it interfaces with other features that already slow the harmonization process. Although we and others need to initially fund our pension plans at an accelerated pace under PPA, our cost recovery is delayed by transition, slower amortization and other features of the cost calculation. In later years, when there is an expectation that cost recovery would occur, recovery still does not occur as by then, the gateway is no longer met. Thus harmonization does not occur in a timely fashion.

But note that even with the elimination of this gateway, there would still be the 5-year transition phase-in, the longer amortization period (10 years versus the 7 years in PPA), and greater asset smoothing than is permitted in PPA. These features will adequately control the cost increases that would otherwise be seen with a more direct and immediate harmonization.

Our recommendation is to remove this gateway or trigger 1 (as it is referenced due to the ordering in the NPRM on the conditions for harmonization).

Effective Date

There are many practical issues associated with implementation of these rules. One of the most important is the timing for which the final rule is included into forward pricing rates and equitable adjustments. The NPRM would make the final rule effective immediately upon publication in the Federal Register with certain contracts priced under existing CAS rules entitled to equitable adjustments (contracts awarded before the effective date of the new rule).

This requirement would present an issue for contracts awarded after the effective date but before the contractor is able to calculate the new forward pricing rates under the final rule. Given the complexity of the rules and calculations, additional time is necessary for us to work with our actuaries to develop and distribute updated pension costs for forward pricing rates.

Our recommendation is that the final rule be made effective 60 days after publication of the final rule in the Federal Register. Contracts awarded in this 60 day period would be subject to equitable adjustment. Here again, we would request that the Board add some illustrations of equitable adjustments to make this process more transparent.

Segment Closings

In situations other than a plan termination, the NPRM retains the current calculation for the adjustment upon a segment closing. This current calculation uses the Actuarial Accrued Liability (AAL) as the basis for the adjustment. We do not believe that this approach can work within a harmonized CAS cost calculation. Further, this current provision would encourage plan terminations which is unlikely to be a desirable outcome for either the Government or the contractor. We believe that the MAL is a better measure of the current value of the liability for the segment closing adjustment calculation.

The AIA/NDIA letter states it bests by saying, “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. Further, 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."

Our recommendation is to use MAL for segment closing adjustment calculations.

We again thank the Board for all its efforts and urge you to consider these comments so that the final rule can appropriately balance the needs of the contractors and the Government.

Respectfully Submitted,

Brad W. Jacobs
Senior Vice President, Finance
BAE Systems, Inc.