

September 6, 2013

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: Fact finding – CAS adjustment for extraordinary events

Dear Mr. Wong:

We appreciate the opportunity the Cost Accounting Standards Board (CASB) has given us to provide these comments about CAS pension adjustments for extraordinary events, based on the notice issued in the Federal Register on July 8, 2013. We recognize the effort that the CASB is making by reaching out to interested parties in the notice and in the two fact finding meetings the CAS working group sponsored. We also appreciate Board's acknowledgement that for many plan sponsors, time is short. Many sponsors may be facing triggering events in the next few years, and a timely resolution of the concerns about CAS's current treatment of closing adjustments will facilitate mutually beneficial outcomes for both the government and its contractors.

The primary issues we would like to see addressed by the CASB are

- whether a benefit curtailment should trigger a closing adjustment,
- how to allocate pension costs when a plan has very few or no active participants earning a benefit, and
- how to measure the liability and closing adjustment when there is a triggering event such as a settlement or loss of a viable, on-going contract base.

Benefit curtailments and other triggering events

Under the current CAS, segment closings and benefit curtailments both trigger a segment closing adjustment. We believe that closing adjustments are an important way to "true-up" or finalize costs when the relationship between the contractor and the government is severed, such as when the contract base is gone and there are no more contracts. A true-up is also important when the plan is settled (usually as the result of a plan termination followed by lump sum payments and annuity purchases for the benefits), because there is no longer a plan. In both of those instances, there is no means of future cost recovery, and a closing adjustment is appropriate to achieve final equity between the government and the contractor.

However, we believe that a benefit curtailment should not trigger an adjustment. Simply curtailing benefits so that participants no longer earn additional benefits in the future does not alter the relationship between the contractor and the government. Nor does the plan dissolve, as it does when a plan is terminated and settled.

Under the current CAS, contractors are reluctant to curtail benefits because of the required adjustment, which is

- disruptive to pricing,
- difficult to determine, and
- leaves the contractor with a plan that will generate future gains and losses, but no clear guidance on whether or not costs created by those gains and losses will be reimbursable, and if they are reimbursable, how the costs will be allocated.



Instead, if curtailments are viewed as a plan change done in the course of on-going business, CAS cost determinations can continue unchanged, with one exception – cost allocation to the business segments.

Pension cost allocation after a curtailment

CAS413 presently provides a method of allocating costs for inactive employees as long as there are at least a few active employees participating in a plan. If a plan has an inactive segment, the costs associated with the inactive segment are allocated to the active segments using pay or headcount of the plan's active participants (413-50(c)(1) and (c)(9)). Such an approach could continue after a curtailment. There would continue to be active participants in the plan who could form the basis for a cost allocation. Those employees have existing plan benefits; they just aren't earning new benefits. Future costs will be the result of amortizing the existing costs and amortizing new gains and losses that arise. There will be no more normal cost (also called service cost).

The existing standard might want to clarify that the allocation base would not be limited to active employees who are earning new benefits, but instead active employees who have existing benefits as well. (The current standard is silent on the distinction in (c)(1), and a clarification could be made in (c)(1) or in an example.)

The standard might also want to address another issue that will likely arise under the current standard and will certainly arise if the standard is changed to remove benefit curtailments from the list of closing adjustment triggers: over time, due to natural attrition, whether or not a benefit curtailment has occurred, it is possible to see distortions in the cost allocation.

For instance, a plan has \$1,000,000 in costs in the inactive segment due to 1,000 retirees and only \$100,000 in costs due to 100 remaining active employees. If the retirees worked predominantly in segment A most of their careers, but the existing employees happen to work in segment B, then the segment A costs are being allocated to segment B. Such situations could be occurring at present under the current standards.

In the above example, and in cases where a curtailed plan's active headcount is low enough that the current allocation is no longer representative of where the costs were incurred, CAS413 could be amended to permit a broader allocation.



Measuring assets and liabilities in segment closings

The working group has posed several questions regarding the how the segment closing adjustment is measured.

It seems that when the time comes to sever the relationship between the government and the contractor (due to the plan going away or the absence of future contract business), the most equitable adjustment would be based on prevailing market conditions at the time of the event. There is no opportunity for smoothing future costs because there is no longer a relationship.

Based on that observation, we would recommend that the asset measurement remain at fair market value, as required in the current standard. We also agree that if the pension obligation is either annuitized or paid as a lump sum to participants (or a combination of the two), then the amount paid should represent the liability measurement.

In cases where the pension obligation remains with the contractor, the liability should be measured using a discount rate and other assumptions that best reflect the current market conditions. Using long-term assumptions will not result in an equitable cost true-up.

The participants in the fact finding meetings explored several possible discount rates based on a continuum from spot-rate to long term smoothing:

- 1) actual cash cost of annuitization and lump sum payments (works only if there is an actual plan termination and all liabilities are settled)
- 2) PBGC term rates (a surrogate for annuitization, but probably tends to overstate liability if contractor keeps the obligation and invests in assets that are not quite as conservative as those assumed by the PBGC)
- 3) Spot bond rate as of a term date or other method now described in CAS 412-50(b)(7)(ii)(A) (close to the GAAP requirements – can be volatile)
- 4) PPA 24 month average (some smoothing of discount rate, dependent on ERISA continuing to define and track the concept)
- 5) PPA with MAP-21 smoothing (even more smoothed than the 24 month average and also ERISA dependent)
- 6) Current long term rate of return (no correlation with actual value of the liability at the time of the closing adjustment)

An approach somewhere within options 3), 4) or 5) will likely yield an equitable result without the risk of too much volatility.

The current standard, with its unrealistically high discount rate, discourages contractors from curtailing or terminating plans. And when the contractors do so, there is strong financial incentive to annuitize so that then contractor will receive market-based reimbursement, even if annuitization proves very costly.



Effective Date of Final Rule

Because many contractors have closed their plans to new hires and because other plans are experiencing natural attrition due to other causes, contractors will soon be facing curtailments. Contractors may soon be facing benefit freezes on plans with non-union participants due to ERISA non-discrimination testing requirements.

Because contractors may be facing the above situation in just a year or two, revising CAS413 is extremely time sensitive. The sooner changes are made, the sooner the contractors can incorporate their impacts in their long term business strategy.

Conclusion

We appreciate this opportunity to provide the CAS board and its working group with our observations and suggestions. We look forward to future opportunities to provide additional information that may be useful for the Board's success in this challenging task.

Sincerely,

Handwritten signature of Michael Lem in black ink.

Michael Lem
Assistant Controller
The Boeing Company

Handwritten signature of Julie Curtis in black ink.

Julie Curtis
Director of Actuarial Services
The Boeing Company