**DEFENSE CONTRACT MANAGEMENT AGENCY**
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SEP 04 2013

Mr. Raymond J.M. Wong
Office of Federal Procurement Policy
725 17th Street NW., Room 9013
Washington, DC 20503

Dear Mr. Wong,

The Defense Contract Management Agency ("DCMA") wishes to take this opportunity to respond to the notice on *Cost Accounting Standards: CAS 413 Pension Adjustments for Extraordinary Events* published in the *Federal Register* on July 8, 2013.

DCMA has Cost Accounting Standards ("CAS") administration responsibility for most contractors doing business with the Department of Defense. We have been in the forefront of overseeing implementation of the Adjustment provisions. It is from this perspective that the following comments are offered:

## I. Complexity of Standard

The level of complexity relative to CAS pension expense has grown exponentially from the initial promulgation in the 1970s to the 1995 revisions and the CAS Pension Harmonization changes made in December 2011. To a large extent the changes to CAS 412 and CAS 413 are being driven by changes in pension accounting that are primarily focused on tax deductibility and Employee Retirement Income Security Act of 1974 ("ERISA") funding. For example, for CAS purposes we now have to consider such funding requirements as Full Funding Limitations, Pension Protection Act, and Moving Ahead for Progress in the 21st Century ("MAP-21") in the computation of CAS pension expense. Such considerations have increased the complexity of the CAS pension expense calculations, while not necessarily properly matching pension costs to cost objectives in the accounting periods in which pension benefits are earned.

The Adjustment has added another layer of complexity to CAS pension accounting. For example, the determination of whether an Adjustment is required, identification of affected contracts, and determination of the United States Government share of a pension asset's surplus or deficit, are just several issues that increased the CAS 413 complexity. In the 8th July *2013 Federal Register* promulgation, it appears that the CASB is focused on additional modifications to the CAS that could very well make the CAS even more complex.

## II. Blank Sheet Approach

Rather than focus solely on the Adjustment process we would encourage the CASB to step back and assess the current environment of defined benefit pension plans and determine if there is a simpler methodology to measure pension expense for Government contracting purposes. More specifically:

1) Defined benefit pension plans are becoming more of the exception than the rule. A significant number of contractors that have existing defined benefit plans in place have already eliminated such benefits to new employees. The vast majority of contractors are offering their employees defined contribution/401(k) types of plans not defined benefit plans,

2) The complexity of the CAS 412 and CAS 413 calculations causes a significant delay between receiving the Contractor's pension expense forecast and confirming the validity of such; resulting in the inability to negotiate forward pricing rates on a timely basis. Since pension costs are typically such a significant component of forward pricing rates, most changes in the pension calculations have an inevitable impact on the forward pricing rates. This is especially true for defined benefits plans where it is difficult to predict long term costs as opposed to forecasting long term cost under defined contribution plans which are more predictable,

3) The intricacy of the CASB harmonization of the CAS with the Pension Protection Act has added yet another level of complexity to computation of CAS pension expense, and

4) Implementation of the CAS 413 Adjustment has caused significant allocation types of issues. For example:

a. There has been a noticeable uptick in Buyers of various companies and segments of companies refusing to accept defined benefit pension plans as part of the sales transaction. The Seller is left to maintain the pension plan assets and liabilities, even though the employees of the plan are transferred to the Buyer's organization, which leads to the issue of proper methodology in allocating future pension costs associated with these pension assets and liabilities that remain with the Seller.

b. Retirees have become a growing percentage of plan participants, due to defined benefit pension plan benefits no longer being offered to new hires. Accordingly, determination of the proper base to allocate inactive pension segment costs to active segment costs has become difficult to identify and a source for debate.

c. There have been significant litigations associated with measuring the segment closing adjustment; particularly as it pertains to determining the Government share.

Accordingly, in light of the aforementioned, we strongly suggest that the CASB analysis go beyond just the Adjustment process, by taking this opportunity to assess, whether a simpler methodology can be developed to measure, assign, and allocate pension costs for Government Contracting purposes. This assessment could include whether a pension plan curtailment should trigger an Adjustment.

## III. Elimination of Adjustment Associated with Pension Plan Curtailment

It is our opinion that curtailment of a qualified defined benefit pension plan that has not been formally terminated and the contractual relationship with the United States Government still exists does not require any Adjustment.

A qualified defined benefit plan may be amended formally to modify any benefits payable or provisions prospectively. For example, suppose a plan had provided a retirement benefit of 1 ½ percent of final average earnings for each year of credited service. If the plan is amended to reduce benefit to 1 percent of final average earnings for service after 1 January 2014 this does not trigger an Adjustment. In another example, an Adjustment is not required when the same plan is amended to change benefit structure to a Cash Balance form of accrual pattern for service after 1 January 2014. A plan amendment to not permit new entrants into the plan by any participant employed on or after 1 January 2014 would also not trigger an Adjustment. Therefore we question why there is an Adjustment required if the plan is amended to reduce benefit to zero percent of final average earnings for service after 1 January 2014. We believe there is no meaningful purpose to require an Adjustment in such a situation, since all of these illustrations would simply result in recognizing the ongoing CAS 412/413 Actuarial Valuations and annual cost determination in a similar manner.

Plainly, any plan amendment is recognized in the measurement of Actuarial Accrued Liability ("AAL"). The difference between AAL becomes an amortization element (of between 10 and 30 years) in the annual assignable CAS cost. Typically on a full curtailment the AAL is reduced creating an Actuarial Gain which results in lower annual cost. In addition, in the event of a full curtailment, the annual CAS normal cost is reduced to zero. Finally, in the normal CAS actuarial process, due to elimination of benefit accruals it is likely the plan will have an Assignable Cost Limit of zero resulting in no assignable CAS costs in the future. A provision for recognizing the gain or loss when the pension plan is actually terminated is still necessary.

## IV. Triggering of Adjustments

In our opinion the following events would justify a CAS 413 closing adjustment:

1) Formal defined benefit plan termination.
The plan is terminated as of a specified date and all liabilities are settled either by lump sum payment or purchase of an annuity contract to individual participants. All obligations of the plan are settled and the pension trust is liquidated. Assets available must cover all liabilities for a Standard Termination to occur and requires cash contribution to cover any shortfall in assets. Any shortfall or surplus in plan assets over liabilities forms the basis of the CAS 413 settlement.

2) Completion of a USG Contractual Arrangement.
The contractual relationship between the Contractor and USG ends. Those participants remaining in defined benefit plans covered by CAS relationship that are now "orphaned" since contractual relationship no longer exists but pension plans does need to be settled since future CAS costs are not reimbursable.

3) Termination of a USG Contractual Arrangement.
A contract is terminated and there no longer exists any contractual relationship between the Contractor and USG. Those participants remaining in defined benefit plans covered by CAS relationship that are now "orphaned" since contractual relationship no longer exists but pension plans does need to be settled since future CAS costs are not reimbursable.

4) Sale of a Business unit or Segment.
A CAS segment or business unit is sold. However, the pension assets and liabilities of either the Inactive and/or Active participants remain with the Seller. These participants in defined benefit plans now are "orphaned" because certain pension plan participants (either Inactives and/or Actives) remain in the Seller's pension plans, even though the employees and contracts are transferred to the Buyer.

## V. Clarification of CAS 413-50(c)(9) Inactive Segments

The cost accounting treatment of the Inactive Segment needs to be clarified. Based on our understanding, the Inactive Segment is treated as a separate pension plan segment that measures annually CAS 412 and 413 costs, experiences its own gains and losses, and is allocated its own assets and liabilities.

The issues that require clarification include:

1) Is this Inactive Segment considered to be its own pension plan segment with its own measurement of CAS Assignable Cost Limit ("ACL")? If so, would ACL of zero set Inactive Segment assignable cost to zero?

2) If this Inactive Segment is not defined as a separate pension plan segment with its own measurement of CAS 412/413 costs, would ACL only be determined for the entire plan (Active and Inactive) and costs be set to zero if entire plan ACL is zero? Could measured CAS 412/413 costs for an Inactive Segment be "negative" or a Credit? If so, based on either (1) or (2) above being applicable, would the entire plan CAS cost be the sum of all costs, both positive and negative?

## VI. Summary

DCMA believes that the implementation of CAS 412 and CAS 413 is overly complex and difficult to administer. Instead of focusing just on the Adjustment process, we encourage the CASB to take this opportunity to assess the current environment/trend of defined benefit pension plans to determine whether a simpler methodology can be established for the measurement, assignment, and allocation of CAS covered pension costs. It is our opinion that such an assessment will find that the denial of defined benefit pension plans to new entrants, buyers refusing to accept pension assets and liabilities in conjunction of the purchases of segments, and the constant impact of ERISA changes on the CAS could lead the CASB to develop a CAS pension accounting that is less complicated and complex than that which currently exists. This simpler CAS should include elimination of pension plan curtailments from triggering an Adjustment if the contractor continues to perform Government contracts.

Should you require additional information of clarification, please contact Bill Romenius at William.Romenius@dcma.mil.

Sincerely,

Timothy P. Callahan

Timothy P. Callahan
Executive Director
Contracts