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November 3, 2008

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: CAS Pension Harmonization ANPRM, 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 Advance Notice of Proposed Rulemaking (ANPRM) issued in the Federal Register of September 2, 2008. We recognize the magnitude of the effort required by the CASB to satisfy the mandate to harmonize CAS 412 and 413 with the Pension Protection Act (PPA). The content of the ANPRM demonstrates the willingness to the CASB to respond to the various perspectives of the multifaceted framework this harmonization effort must consider to achieve the purpose intended by Congress.

Although our response to the Staff Discussion Paper encouraged the CASB to consider a new rule that is based on the same underlying methods and assumptions for developing the PPA minimum contribution, we understand that given the time constraints imposed by Congress, the challenge of reconstructing entirely the method of pension cost calculation could arguably not have been completed by the deadline. Furthermore, we recognize that if such an approach would have been attempted and completed in haste, the result could have been disastrous for both the Government and industry. We appreciate the CASB explaining their approach and goals for harmonization in the ANPRM Supplemental Information. Accordingly, we support the approach set forth by the CASB and applaud the quality of this ANPRM in addressing the differences between current CAS and the PPA. We believe this ANPRM makes considerable progress towards achieving harmonization of CAS with PPA.

Given the approach of the CAS Board in this effort, we believe that harmonization will be achieved when the CAS rules provide for government contractors to 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. Essentially, we expect the CAS rules to seek a fair and equitable balance between timely cost recovery and volatility, as well



as fulfill their primary objective of uniformity and consistency in cost accounting practices. We believe that the ANPRM provides for harmonization in several respects. First, the minimum actuarial liability (MAL) is aligned with the shorter term perspective of the PPA. In addition, using the greater of the minimum actuarial liability (MAL) or the actuarial accrued liability (AAL) acknowledges differences in the pension liability measurements depending upon the economic environment (e.g. high interest rates, low interest rates), and using both is likely to result in a more stable measure over time as economic conditions change. Second, the mandatory prepayment credit is a successful vehicle in directly addressing the Congressional mandate to harmonize CAS with the PPA minimum required contributions. We believe the 5 year amortization period for mandatory prepayment credits is a fair and equitable balance between timely cost recovery and the introduction of volatility. Third, the shortened amortization period of actuarial gains and losses from 15 to 10 years is a fair and equitable balance of recognition of these amounts in cost without the introduction of undue volatility while achieving closer alignment with the 7 year period used by PPA. We generally regard the ANPRM as a reasonable compromise between timely cost recovery and volatility that successfully balances the interests of industry and the Government. In addition, we believe the transition rules provided in the ANPRM, while lengthy in duration and a bit complex, are justified given the current economic environment and its likely effect on government contracting.

In reviewing the ANPRM, 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 Industries Association. There are a few of those areas we would like to take this opportunity to emphasize further in this letter.

Discretionary and Mandatory Funding

The development of the concept of mandatory prepayments added complexities to the rule, such as the criteria for classification of contributions in excess of CAS pension costs and the order of funding used when contributions are lower than CAS cost. We believe that one complexity was not provided for in the ANPRM—the treatment of previously discretionary contributions and their effect on funding new PPA required contributions. Without a mechanism in CAS to address this, two contractors who have the same PPA minimum funding requirement amounts and make the same contributions over a period of time will have different cost recovery. The contractor who funds only the PPA minimum each year will have faster cost recovery than the contractor who maintains a funding reserve (commonly referred to as ERISA credits) and continues to fund the same PPA minimum requirements with new contributions. Since a primary objective of the CAS Board is “consistency in cost accounting practices in like circumstances by individual Government contractors over periods of time”, such a result cannot be intended.



There are two revisions that we recommend to provide for consistency among contractors regardless of funding patterns. These revisions respect the underlying principles that (1) discretionary funding is not recovered until it is used to fund CAS pension cost and (2) the PPA minimum requirement is the baseline for determining contributions that are mandatory or voluntary prepayments. The first revision we recommend to address our concern is in the definition of “minimum required funding” in CAS 412-30(a)(18). The calculation for PPA to determine the minimum amount of funding required does not take ERISA credits into consideration, correspondingly CAS should not include those credits in determining the “minimum required contribution”. The ERISA credits are discretionary funds that may or may not be used to fund the PPA requirements. If they are used for funding, then to that extent those amounts become required funding not discretionary. The analogous CAS concept to ERISA credits is voluntary prepayments. Thus, as discretionary funding under PPA is contributed, those funds are classified as voluntary prepayments. If a contractor with an ERISA credit (voluntary prepayment) makes another contribution required by PPA, those new funds are regarded as required by PPA. However, because the CAS definition of the PPA minimum requirement is reduced by the ERISA credit, the contribution made will be considered voluntary, while the original contribution that generated the ERISA credit remains a voluntary contribution as well. The “minimum required contribution” definition should be revised to align with PPA by not reducing the amount by the ERISA credits. We recommend revising the second sentence in CAS 412-30(a)(18) to read, “The contribution amount shall not be reduced by any ERISA pre-funding credits (e.g. credit balances, carry-over balances, prefunding balances).”

The second revision we recommend is a mechanism in CAS that reflects when previously discretionary contributions are used to meet the PPA minimum required funding. When an ERISA credit is used to fund a PPA minimum requirement, the ERISA credit is reduced by that amount, likewise the voluntary prepayment credit that was generated by the ERISA credit should have an analogous adjustment from voluntary to mandatory. We recommend adding a new subsection at CAS 412-50(a)(4)(ii)(E) to describe this treatment for voluntary prepayment credits that reads, “The value of the voluntary prepayment account shall be reduced for portions of the accumulated value of voluntary prepayment credits used to fund the minimum required funding as determined by the application of ERISA credits to fund the minimum required funding during the period. The value by which the voluntary prepayment account is reduced shall be added to the mandatory prepayment account and accounted for in accordance with 9904.412-50(a)(4)(i).”

We have included illustrations in the attachment to this letter regarding this issue. Illustration 1 demonstrates the inequitable cost treatment to contractors with different funding patterns that results under the ANPRM. Illustration 2 demonstrates that revision of the definition of “minimum required funding” to exclude ERISA credits is insufficient alone to bring the contractors to parity. Illustration 3 demonstrates that the addition of a method to convert voluntary prepayments (i.e. discretionary funding) to mandatory prepayments (i.e. required funding) is insufficient alone to bring the contractors to parity. Finally, Illustration 4 demonstrates that both of these recommended revisions together successfully bring the contractors parity in cost treatment regardless of their funding patterns.

Contractor's Best Estimate for Interest Rate

CAS 412-40(b)(3)(ii) provides for an interest rate to be used for the calculation of the minimum actuarial liability (MAL) and the minimum normal cost (MNC) that is the "contractor's best estimate". We believe the criteria intended by the ANPRM in selecting the source for this interest rate should be clarified, since it is unclear whether a short term or long term rate is used. We understand the MAL to provide for a shorter term measure of the liability similar to the PPA or FASB calculations. This intent could be clarified in the rule by revising the first sentence to read, "...contractor's best estimate of rates at which the pension benefits could effectively be *currently* settled based on rates of return..."



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Implementation of the Final Rule

We understand that when the CAS Board issues the final harmonized rule, we will need to change our cost accounting practices to comply with it, and that this will be a required change as defined by CAS. We also understand that PPA requires the new harmonized CAS rule to be issued no later than January 1, 2010 and effective no later than January 1, 2011. Given the remaining efforts in the promulgation process, we believe publication of the final rule is likely to be published late in 2009. We agree with the ANPRM that the rule should be effective immediately, so that contractors can begin incorporating the effects of the new rule into pricing. We understand that the rule will then become applicable for a contractor in the year following receipt of a new contract or subcontract covered by CAS. We believe the CAS Board intends for the final rule to be applicable to all CAS covered contracts of the contractor after the applicability date not just new contracts, so contractors will be calculating pension costs under only the new CAS rules. However, this is unclear in the ANPRM. Accordingly, we recommend revising CAS 412-63(c) to read, "Contractors with prior CAS-covered contracts with full coverage shall continue to follow the Standard 9904.412 in effect prior to [Date published in the Federal Register], 2009, until this Standard, effective [Date published in the Federal Register], 2009, becomes applicable prospectively to all CAS covered contracts and subcontracts following receipt of a contract or subcontract to which this Standard applies." A corresponding change is recommended to CAS 413-63(c) as well.

Given the complexities of these rules, we encourage the CAS Board to take advantage of publishing a second ANPRM before proceeding in the promulgation process to allow industry another opportunity to support the Board in reviewing the draft rules. We believe that public comments provide the CAS Board broader insights into the clarity of the language by those responsible for the practical application of the rules and alert the CAS Board to any unintended consequences. Given the challenge of meeting the Congressional deadline, we understand if the CAS Board proceeds to a NPRM. However, should there be significant revisions considered to the NPRM, we strongly encourage the CAS Board to evaluate whether another NPRM would be beneficial before a final rule is issued.

We appreciate this opportunity to provide the CAS Board information we hope will be helpful in the harmonization of CAS 412 and 413 with PPA. 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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Michael D. Lem
Assistant Controller

Illustration 1: ANPRM treatment dependent on contractor funding patterns

ANPRM Treatment of contractors with different funding patterns	Contractor 1 Early Funding	Contractor 2 Med Fund Early ERISA Cr use	Contractor 3 Med Fund Later ERISA Cr use	Contractor 4 Later Funding
Year 1 PPA Min Req Fund \$100 (before ERISA Cr)	Contributes \$600 ERISA Cr \$0 Man PP \$100 Vol PP \$500	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$100 ERISA Cr \$0 Man PP \$100 Vol PP \$0
Year 2 PPA Min Req Fund \$200 (before ERISA Cr)	Contributes \$0 ERISA Cr \$500 \$200 applied to fund Man PP \$100 Vol PP \$500	Contributes \$200 ERISA Cr \$200 None applied to fund Man PP \$100 Vol PP \$200+\$200=400	Contributes \$0 ERISA Cr \$200 \$200 applied to fund Man PP \$100 Vol PP \$200	Contributes \$200 ERISA Cr \$0 Man PP \$100+\$200=300 Vol PP \$0
Year 3 PPA Min Req Fund \$300 (before ERISA Cr)	Contributes \$0 ERISA Cr \$300 \$300 applied to fund Man PP \$100 Vol PP \$500	Contributes \$100 ERISA Cr \$200 \$200 applied to fund Man PP \$100+\$100=200 Vol \$400	Contributes \$300 ERISA Cr \$0 Man PP \$100+\$300=400 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$300+\$300=600 Vol PP \$0
Total PPA Min Req \$600 (excluding ERISA CR) for all contractors All contractors contributed \$600 All contractors end Year 3 with ERISA Cr of \$0	Contractor who funds early has almost all contributions classified as voluntary prepayments	Contractor who contributes additional funds rather than immediately applying ERISA Cr has more contributions classified as voluntary	Contractor who applies ERISA Cr immediately has more contributions classified as mandatory	Contractor who limits contributions to PPA min has all classified as mandatory prepayments with recovery within 5 years and no voluntary prepayments

Note: CAS Pension costs assumed to be zero each year. The amortization calculations for the mandatory prepayment credits are ignored for simplicity of the illustration.

Illustration 2: Proposed revision eliminating ERISA credits from definition of minimum required funding definition

ANPRM Treatment of contractors with different funding patterns	Contractor 1 Early Funding	Contractor 2 Med Fund Early ERISA Cr use	Contractor 3 Med Fund Later ERISA Cr use	Contractor 4 Later Funding
Year 1 PPA Min Req Fund \$100 (before ERISA Cr)	Contributes \$600 ERISA Cr \$0 Man PP \$100 Vol PP \$500	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$100 ERISA Cr \$0 Man PP \$100 Vol PP \$0
Year 2 PPA Min Req Fund \$200 (before ERISA Cr)	Contributes \$0 ERISA Cr \$500 \$200 applied to fund Man PP \$100 Vol PP \$500	Contributes \$200 ERISA Cr \$200 None applied to fund Man PP \$100+200=300 Vol PP \$200	Contributes \$0 ERISA Cr \$200 \$200 applied to fund Man PP \$100 Vol PP \$200	Contributes \$200 ERISA Cr \$0 Man PP \$100+200=300 Vol PP \$0
Year 3 PPA Min Req Fund \$300 (before ERISA Cr)	Contributes \$0 ERISA Cr \$300 \$300 applied to fund Man PP \$100 Vol PP \$500	Contributes \$100 ERISA Cr \$200 \$200 applied to fund Man PP \$300+100=400 Vol \$200	Contributes \$300 ERISA Cr \$0 Man PP \$100+300=400 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$300+300=600 Vol PP \$0
Total PPA Min Req \$600 (excluding ERISA CR) for all contractors All contractors contributed \$600 All contractors end Year 3 with ERISA Cr of \$0	Contractor who funds early has almost all contributions classified as voluntary prepayments	Contractor who funds earlier & defers applying ERISA Cr has more contributions classified as voluntary than later contributor (4), but has parity with contractor 3 with credits	Contractor who funds earlier & immediately applies ERISA Cr has more contributions classified as voluntary than later contributor (4), but has equity with contractor 3 with credits	Contractor who limits contributions to PPA min has all classified as mandatory prepayments with recovery within 5 years and no voluntary prepayments

Note: CAS Pension costs assumed to be zero each year. The amortization calculations for the mandatory prepayment credits are ignored for simplicity of the illustration.

Shows the effect of the revision to only the definition (i.e. without the additional recommended revision to convert discretionary funding to required funding).

Illustration 3: Proposed revision to add provision to convert discretionary funding to required funding

ANPRM Treatment of contractors with different funding patterns	Contractor 1 Early Funding	Contractor 2 Med Fund Early ERISA Cr use	Contractor 3 Med Fund Later ERISA Cr use	Contractor 4 Later Funding
Year 1 PPA Min Req Fund \$100 (before ERISA Cr)	Contributes \$600 ERISA Cr \$0 Man PP \$100 Vol PP \$500	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$100 ERISA Cr \$0 Man PP \$100 Vol PP \$0
Year 2 PPA Min Req Fund \$200 (before ERISA Cr)	Contributes \$0 ERISA Cr \$500 \$200 applied to fund Man PP \$100+200=300 Vol PP \$500-200=300	Contributes \$200 ERISA Cr \$200 None applied to fund Man PP \$100 Vol PP \$200+200=400	Contributes \$0 ERISA Cr \$200 \$200 applied to fund Man PP \$100+200=300 Vol PP \$200-200=0	Contributes \$200 ERISA Cr \$0 Man PP \$100+200=300 Vol PP \$0
Year 3 PPA Min Req Fund \$300 (before ERISA Cr)	Contributes \$0 ERISA Cr \$300 \$300 applied to fund Man PP \$300+300=600 Vol PP \$300-300=0	Contributes \$100 ERISA Cr \$200 \$200 applied to fund Man PP \$100+100+200=400 Vol \$400-200=200	Contributes \$300 ERISA Cr \$0 Man PP \$300+300=600 Vol PP \$0	Contributes \$300 ERISA Cr \$0 Man PP \$300+300=600 Vol PP \$0
Total PPA Min Req \$600 (excluding ERISA CR) for all contractors All contractors contributed \$600 All contractors end Year 3 with ERISA Cr of \$0	Contractor who funds early has voluntary prepayments when they are discretionary funds before they are used to fund Min Req	Contractor who contributes additional funds rather than immediately applying ERISA Cr has additional contributions classified as voluntary though no ERISA credit left at yr 3 voluntary credit still remains	Contractor who applies ERISA Cr immediately has more contributions classified as mandatory	Contractor who limits contributions to PPA min has all classified as mandatory prepayments with recovery within 5 years and no voluntary prepayments

Note: CAS Pension costs assumed to be zero each year. The amortization calculations for the mandatory prepayment credits are ignored for simplicity of the illustration.

* Shows the effect of the revision to only add the conversion of discretionary funding to required funding (i.e. without the additional recommended revision to the definition of minimum required funding to exclude ERISA credits).

Illustration 4: Proposed CAS treatment providing for consistent cost recovery for different contractor funding patterns

Treatment of contractors with different funding patterns under recommended revisions	Contractor 1 Early Funding	Contractor 2 Med Fund Early ERISA Cr use	Contractor 3 Med Fund Later ERISA Cr use	Contractor 4 Later Funding
Year 1 PPA Min Req Fund \$100	Contributes \$600 ERISA Cr \$0 Man PP \$100 Vol PP \$500	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$300 ERISA Cr \$0 Man PP \$100 Vol PP \$200	Contributes \$100 ERISA Cr \$0 Man PP \$100 Vol PP \$0
Year 2 PPA Min Req Fund \$200	Contributes \$0 ERISA Cr \$500 \$200 applied to fund Man PP \$100+200=300 Vol PP \$500-200=300	Contributes \$200 ERISA Cr \$200 None applied to fund Man PP \$100+200=300 Vol PP \$200	Contributes \$0 ERISA Cr \$200 \$200 applied to fund Man PP \$100+200=300 Vol PP \$200-200=0	Contributes \$200 ERISA Cr \$0 Man PP \$100+200=300 Vol PP \$0
Year 3 PPA Min Req Fund \$300	Contributes \$0 ERISA Cr \$300 \$300 applied to fund Man PP \$300+300=600 Vol PP \$300-300=0	Contributes \$100 ERISA Cr \$200 \$200 applied to fund Man PP \$300+100+200=600 Vol \$200-200=0	Contributes \$300 ERISA Cr \$0 Man PP \$300+300=600 Vol PP \$0	Contributes \$300 ERISA Cr \$0 Man PP \$300+300=600 Vol PP \$0
Total PPA Min Req \$600 (excluding ERISA CR) for all contractors All contractors contributed \$600 All contractors end Year 3 with ERISA Cr of \$0				

Note: CAS Pension costs assumed to be zero each year. The amortization calculations for the mandatory prepayment credits are ignored for simplicity of the illustration.

Shows the combined effects of the revising both the definition of minimum required funding to exclude ERISA credits and the addition of a provision to convert discretionary funding to required funding.