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August 22, 2007

Via email to casb2@omb.eop.gov, and regular US mail.

Cost Accounting Standards Board
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Office of Federal Procurement Policy
725 17th Street, NW, Room 9013
Washington, DC 20503

Re: CAS–2007–02S

This letter presents our response to some of the issues presented in the Staff Discussion Paper, issued on July 3, 2007 by the Cost Accounting Standards Board, regarding the harmonization of CAS 412 and 413 with the Pension Protection Act of 2006 ("PPA").

There are a variety of issues and questions raised in the SDP that require a more detailed actuarial analysis, and are probably best addressed by the actuaries performing the CAS pension valuations. However, there are certain fundamental issues regarding the "harmonization" of CAS 412 and 413 with the minimum funding requirements of PPA that potentially affect all government contractors. We have provided specific comments on the applicability of CAS changes to all government contractors, actuarial liability determinations and assumptions, and the impact on existing contracts and prepayment credits.

Overall in order to provide harmonization with the new PPA minimum funding rules, we believe that there should be changes to the CAS 412 and 413 pension calculations, such that the CAS allowable amounts are based on liabilities determined the same as (or very similar to) the liabilities determined for the new PPA minimum funding calculations. Furthermore, any such changes to CAS rules should apply to all contractors subject to the CAS 412 and 413 rules and not just the "eligible government contractors" as defined in section 106 of PPA.

Eligible Government Contractors

Section 106 of PPA included a definition of "eligible government contractors" that applies to only very large contractors (those with over $5 billion in government contracts in 2007). This section of PPA provides that the new minimum funding rules are deferred for such companies for up to three additional years, during which time the CAS Board is instructed to "harmonize" the requirements of CAS 412 and 413 with the new minimum funding rules.

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We believe that the CAS Board should apply any revisions to all contractors for a variety of reasons, including:

- The PPA language of Section 106 was not meant to exclude smaller government contractors from any CAS harmonization changes—rather, the exemption was only for a deferral of the new PPA minimum funding rules.

- It makes no sense to have two different sets of pension accounting rules for government contractors based on size—a single set of rules better achieves the uniformity goal of CAS among contractors.

- Two sets of rules may put small contractors at a disadvantage if they have to factor in higher pension costs based on a different set of rules.

- Multiple rules could be confusing, especially in the case of a contractor moving into or out of the "eligible government contractor" designation in a given year, or possibly in the forward pricing years.

- A single set of rules provides an easier basis for auditing contract costs and monitoring compliance with CAS.

Harmonization of Calculation of Plan Liabilities
Probably the biggest difference between CAS pension accounting rules and the new PPA funding rules is the determination of the plan liabilities used to determine the annual cost for the plan.

Under PPA we will be required to value the pension plan liabilities using a Corporate Bond discount rate basis and specified mortality tables. The discount rate under PPA may be 200 or more basis points lower than the current CAS funding rate which is based on the "best estimate" of the long-term investment returns for the pension trust investments. The result will be a much higher liability amount for the plan calculated under the PPA assumptions, and a PPA minimum required contribution well in excess of the CAS amounts for many years to come.

If the CAS rules are changed to allow (or require) the use of the same liability determination, including discount rate and mortality assumptions as will be required under PPA, most of the other differences between CAS and PPA annual cost determinations would be viewed as minor. We believe that this is the single most important item for harmonizing the CAS rules with the new PPA minimum funding requirements. The CAS rules should be revised to use the same liability and normal cost amounts as used in the new PPA funding requirements.

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We do not believe the Board needs to include the "at risk" calculation of liabilities under PPA, as that is generally a temporary condition for a plan under PPA, to help insure the solvency of the plans for severely underfunded plans. Once a plan becomes better funded the PPA calculations return to the regular target liability basis.

Additional Harmonization Areas

Additional harmonization could be accomplished if the CAS rules were further revised to provide for a seven-year amortization period for actuarial gains/losses rather than the current 15-year requirement. Other changes in unfunded accrued liabilities can be amortized over periods as short as 10 years under current CAS rules. So this may not be significantly different than the 7-year amortization period under PPA (although for better harmonization, a 7-year amortization applied to all changes may be better).

PPA also changes the determination of actuarial value of assets used in the annual cost determinations, by decreasing the smoothing period from 5 years to 24 months, and reducing the applicable corridor from an 80% to 120% range around market value to only a 90% to 110% range. The result will be much greater year-to-year volatility in the actuarial value of assets and resulting PPA minimum contribution. CAS currently allows the prior ERISA smoothing techniques. Since forward pricing and contract bids often extend well beyond two years, continuing to allow for the greater smoothing of assets under CAS would provide for more predictable costs and less year-to-year volatility, and thus would provide for a better basis to forecast pension costs. Ultimately the assets are smoothed toward the same market value so this is not a long-term cost difference. However, this may be an area where a difference between CAS and the new PPA rules is advisable to keep, since it would provide for better forward pricing and more predictable contract costs.

Finally, prepayment credits in CAS are similar to the credit balances in ERISA funding. PPA changes the way credit balances grow with interest each year, to be based on actual market returns as opposed to the underlying valuation interest rate. Harmonizing CAS and PPA could mean changing the CAS prepayment growth to use actual market returns as well, but we think this adds more complexity to the calculations than is likely warranted by the change. Additionally, prepayment credits are not the same as credit balances, and one might argue that there is no need to harmonize these two items.

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Applicability of Any CAS Changes

For contractors that do not qualify for PPA's deferred starting date (e.g., contractors that do not meet the PPA definition of "eligible government contractor"), PPA will require higher minimum contributions beginning in 2008. This will likely be several years before any harmonization changes to CAS are completed. As a result, any changes to CAS should provide for equitable treatment of these initial PPA costs, either through a retroactive adjustment to contact costs, or some reasonable future amortization period for the higher costs. This should apply equally to both cost and fixed-priced type contracts entered into after the effective date of PPA for the contractor.

Additionally, if the CAS liability calculations are changed, the Board should consider whether an adjustment to previously bid contracts, whether cost or fixed-price, should be included in the changes.

Any changes to CAS ought to preserve and allow contractors the continued ability to recover existing prepayment credits in future cost accounting periods as well.

Conclusions

We appreciate the opportunity to provide these comments regarding the harmonization of PPA and CAS pension costs. In our opinion, the two greatest areas of concern that we hope the Board will consider are: (1) that any CAS changes apply equally to all contractors subject to CAS 412 and 413; and (2) that the CAS calculation of accrued liability and normal cost be changed to use the same new PPA target liability definition including both discount and mortality assumptions.

Sincerely,

James T. Hardin, Jr.
Vice President & Controller
United Launch Alliance