financial executives international

Committee on Benefits Finance and Committee on Government Business

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Cost Accounting Standards Board
Office of Federal Procurement Policy
725 17th Street, N.W., Room 9013
Washington, D.C. 20503
Attn: Laura Auletta

RE: CAS-2007-02S

Dear Sir or Madam:

We are writing on behalf of Financial Executives International ("FEI")'s Committee on Benefits Finance and Committee on Government Business to comment on the Staff Discussion Paper by the Office of Federal Procurement Policy, Cost Accounting Standards Board ("Board") in 72 Fed. Reg. 36,508 (July 3, 2007). FEI's Committee on Benefits Finance and Committee on Government Business welcome the opportunity to present their views in response to the Staff Discussion Paper.

FEI's membership is composed of 15,000 individuals who serve as executives in public and private companies of all industries and sizes. FEI plays an active role in monitoring and participating in the development of emerging issues, and in turn passes this information along to its members for implementation in the business world as a whole. Many of FEI's members work for companies that are directly affected by the changes enacted in the Pension Protection Act of 2006 ("PPA") and the resultant changes needed to harmonize the Cost Accounting Standards with the new minimum funding rules governing pension plans. The comments below reflect the views of FEI's Committee on Benefits Finance and Committee on Government Business members who have had extensive experience with those issues.

Section 106 of the PPA directs the Board to harmonize Cost Accounting Standards 412 and 413 (together, "CAS 412 and 413") with the minimum required contribution provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 (the "Code"), as amended by the PPA (collectively, the "minimum funding rules"). FEI's Committee on Benefits Finance and Committee on Government Business strongly believe that the Board must revise CAS 412 and 413 in light of the changes enacted in the PPA.

The PPA reflects congressional ratification of the growing international consensus that pension obligations and assets should be measured to the extent possible on a mark-to-market basis. CAS 412 and 413 now must be updated to reflect that reality. At the same time, and fully consistent with the PPA changes, it is important that revisions to CAS 412 and 413 be promulgated in a manner that ensures that government contractors are equitably reimbursed for their pension costs; are treated uniformly relative to each other; and are allowed to recover charges attributable to a contract as they are incurred. Those underlying principles should dictate the Board's consideration of changes to CAS.

FEI's Committee on Benefits Finance's and Committee on Government Business' views are expressed in more detail below, maintaining the question-and-answer format utilized by the Staff Discussion Paper.

> **Question 1: Should the Board apply any revisions to all cost-based contracts and other Federal awards that are subject to full CAS coverage, or only to "eligible government contractors" as defined in Section 106?**

FEI's Committee on Benefits Finance and Committee on Government Business strongly believe that all revisions should be applied to all contractors, regardless of status under PPA section 106. Because the main impetus behind the Staff Discussion Paper is to create "harmonization" between the PPA and CAS 412 and 413, it seems counterproductive to impose different systems depending on the characteristics of a contractor or government plan. If a contractor has revenues of less than $5 billion dollars, it will not be considered an "eligible government contractor." Some contractors may not be sure if they qualify as an eligible government contractor until the start of the year has already passed in which case they would not have been able to prospectively identify which accounting rules they will be subject to. This lack of predictability could cause administrative difficulties for the contractor or plan.

More importantly, having a different, more lenient accounting rule for large contractors provides the large contractors with unfair, competitive advantages over smaller contractors. Larger contractors will be able to get reimbursed for PPA required costs more fully than will smaller contractors. Two sets of rules, one for large contractors and one for small contractors, will be difficult to administer and inherently unfair. PPA does not provide for different levels of contributions to benefit plans based on the size of the contractor. Rules that provide for reimbursement for these congressionally mandated, PPA required contributions should not provide for two levels of reimbursement.

Question 2: Does the current CAS 412 and 413 substantially meet the Congressional intent of the PPA to protect retirement security, to strengthen funding and ensure PBGC solvency?

As currently drafted, CAS 412 and 413 as a whole do not align with the purposes embedded in the PPA or with the equitable treatment of government contractors under the new plan funding regime in the PPA. The PPA section 106 harmonization mandate reinforces this opinion, and FEI's Committee on Benefits Finance and Committee on Government Business believe that the final CAS harmonization rule should bring CAS 412 and 413 into conformance with the PPA. Harmonization that ensures full, fair and timely reimbursement of government contractors will further the fundamental policies underlying the enactment of PPA -- improving plan funding and thereby providing greater assurance that plan participants will receive all their promised benefits while also minimizing risks to the PBGC.

Question 3: Should CAS harmonization be focused only on the relationship of the PPA minimum required contribution and the contract cost determined in accordance with CAS 412 and 413?

FEI's Committee on Benefits Finance and Committee on Government Business believe that the PPA section 106 harmonization mandate generally requires that CAS 412 and 413 be reformed to embody the concepts of the PPA. Since its inception, however, CAS 412 and 413 have generally focused on balancing the minimum required contribution under ERISA and the "recovery" of pension contributions made by contractors. FEI's Committee on Benefits Finance and Committee on Government Business support retention of this basic concept in formulating revisions to CAS 412 and 413.

Question 3(a): Do the measurement and assignment provisions of the current CAS 412 and 413 result in a contractor incurring a penalty under ERISA in order to receive full reimbursement of CAS computed pension costs under Government contracts?

In a number of cases, minimum funding requirements as revised by the PPA can be expected to mandate pension contributions in excess of pension costs under CAS 412 and 413. This could result in substantial and potentially very troublesome cash flow problems for some contractors. In no event should the revised CAS 412 and 413 result in required contributions that result in the imposition of excise taxes and that rule should be explicitly retained.

Question 3(b): To what extent, if any, should the Board revise CAS 412 and 413 to harmonize with the contribution range defined by the minimum required contribution and the tax-deductible maximum contribution?

Generally, changes in the contribution range would not be required to the extent CAS 412 and 413 are modified to more closely resemble a mark-to-market methodology. CAS 412 and 413 currently provide that pension costs cannot be greater than the sum of the maximum deductible

amount and prepayment credits. FEI's Committee on Benefits Finance and Committee on Government Business support the notion that this limit be retained.

Question 3(c): To what extent, if any, should ERISA credit balances (carryover and prefunding balances) be considered in revising CAS 412 and 413?

Credit balances are one aspect of the PPA minimum funding rules that should not be imported wholesale into CAS 412 and 413. While the general PPA approach to credit balances is similar in many ways to CAS prepayment credits and should be carefully considered in modifying CAS, the rules governing prepayments must also be tailored to the unique government cost accounting context.

Question 3(d): To what extent, if any, should revisions to CAS be based on the measurement and assignment methods of the PPA?

FEI's Committee on Benefits Finance and Committee on Government Business believe that revisions to CAS 412 and 413 should operate largely to bring it into conformance with the measurement and assignment methods of the PPA. This will help eliminate confusion and facilitate the interplay between CAS and the PPA. The concepts and terminology of the PPA should be substituted for the parallel concepts and terminology found in CAS 412 and 413. This will help with the harmonization process and to eliminate confusion for parties trying to comply with both procedures.

Question 3(d)(i): To what extent, if any, should the Board revise the CAS based on rules established to implement tax policy?

As discussed above, FEI's Committee on Benefits Finance and Committee on Government Business believe that harmonization is appropriate for a number of reasons. This view is not affected by the tax, retirement or other federal policies that underlie the PPA.

Question 3(d)(ii): To what extent, if any, should the Board consider concerns with the solvency of either the pension plan, or the PBGC?

FEI's Committee on Benefits Finance and Committee on Government Business do not believe that the Board should be concerned with the solvency of either the pension plan or the PBGC. This is not the purview of the Board.

Question 4(a): For Government contract costing purposes, should the Board (i) retain the current "going concern" basis for the measurement and assignment of the contract cost for the period, or (ii) revise CAS 412 and 413 to measure and assign the period cost on the liquidation or settlement cost basis of accounting?

FEI's Committee on Benefits Finance and Committee on Government Business believe that the CAS method of measurement and assignment should be brought into line with those of the PPA.

From a practical perspective, if CAS retains its present measurement and assignment method, then it is inevitable that significant additional costs and confusion would result. Costs would increase because two different types of training and technology would be required for one evaluation of the measurement and assignment of the contract cost. Moreover, no other regulator requires use of the CAS "going concern" method and it is clear that this is an outdated mode of valuation.

> **Question 4(b): For contract cost measurement, should the Board (i) continue to utilize the current CAS requirements which incorporate the contractor's long-term best estimates of anticipated experience under the plan, or (ii) revise the CAS to include the PPA minimum required contribution criteria, which include interest rates based on current corporate bond yields, no recognition of future period salary growth, and use of a mortality table determined by the Secretary of the Treasury?**

FEI's Committee on Benefits Finance and Committee on Government Business believe that the Board should revise CAS 412 and 413 to adopt the PPA minimum required contribution criteria. A contractor should have to use the same assumptions with respect to CAS as it uses for purposes of the minimum funding rules.

> **Question 4(c)(i)(1): For measuring the pension obligation, what basis for setting interest rate assumptions would best achieve uniformity and/or the matching of costs to benefits earned over the working career of plan participants?**

FEI's Committee on Benefits Finance and Committee on Government Business believe that CAS 412 and 413 should utilize the same interest rates that are adopted by the PPA. This will help achieve uniformity between the two procedures. If a system of uniform interest rates is adopted, then the relationship between costs and benefits should be more easily observed over the course of a plan participant's career.

> **Question 4(c)(i)(2): To what extent, if any, should the interest rate assumption reflect the contractor's investment policy and the investment mix of the pension fund?**

CAS 412 and 413 should adopt the interest rates employed by the PPA. If so adopted, CAS interest rate assumptions do not need to take into account either (i) the contractor's investment policy or (ii) the investment mix of the pension fund.

> **Question 4(c)(ii): For measuring the pension obligation, should the CAS exclude, permit or require recognition of future period salary increases?**

The PPA generally disregards the effects of future salary increases in determining minimum required contributions. FEI's Committee on Benefits Finance and Committee on Government Business feel that CAS 412 and 413 should take a similar approach.

> **Question 4(c)(iii): For measuring the pension obligation, should the CAS exclude, permit or require use of a (1) standardized mortality table, (2) company-specific mortality table, or (3) mortality table that reflects plan-specific or segment-specific experience?**

CAS 412 and 413 should adopt the limited flexibility that the PPA allows with respect to mortality tables, including use of a substitute mortality table, if appropriate.

> **Question 4(d): For contract cost measurement, should the board (i) retain the current amortization provisions allowing amortization over 10 to 30 years (15 years for experience gains and losses), (ii) expand the range to 7 to 30 years for all sources including experience gains and losses, (iii) adopt a fixed seven year period consistent with the PPA minimum required contribution computation, or (iv) adopt some other amortization provision?**

FEI's Committee on Benefits Finance and Committee on Government Business suggest that the Board adopt a fixed seven year period consistent with the PPA.

> **Question 4(e)(i): For contract cost measurement, should the Board restrict the corridor of acceptable actuarial asset values to the range specified in the PPA (90% to 110% of the market value)?**

FEI's Committee on Benefits Finance and Committee on Government Business believe that the Board should accept actuarial asset values that fall within the corridor of market values that is prescribed by the PPA (generally, 90% to 110% of the market value).

> **Question 4(e)(ii): For contract cost measurement, should the Board adopt the PPA's two year averaging period for asset smoothing?**

FEI's Committee on Benefits Finance and Committee on Government Business believe that the Board should adopt the PPA's two year averaging period for asset smoothing.

> **Question 5: To what extent, if any, should the Board revise the CAS to include special funding rules for "at risk" plans?**

The at risk rules address an entirely different set of concerns than CAS 412 and 413 and FEI's Committee on Benefits Finance and Committee on Government Business strongly believe that the Board should not provide special rules for "at risk" plans. Instead, the Board should impose the funding rules used under the PPA with respect to all plans, whether at risk or not.

Question 6(a): To what extent, if any, should the measurement and assignment provisions of CAS 412 and 413 be revised to address contractor cash flow issues?

One of the primary goals of harmonization is to minimize the extent of negative cash flow that contractors would suffer due to PPA minimum funding requirements exceeding assignable costs under the current CAS 412 and 413. So long as harmonization is maximized, no special provisions should be required in CAS 412 and 413.

Question 6(b): To what extent, if any, do the current prepayment provisions mitigate contractor cash flow concerns?

The current prepayment provisions mitigate cash flow concerns only to the extent the concerns are "temporary" rather than permanent. The problem with the current rules, however, is that "temporary" could mean many years or even decades. For many contractors, such a definition of "temporary" is barely distinguishable from "permanent."

Question 6(c): To what extent, if any, should the prepayment credit provision be revised to address the issue of potential negative cash flow?

No revisions to the current prepayment provisions should be needed to address potential negative cash flow as long as harmonization is maximized.

Question 7(a)(i): To what extent, if any, would adoption of some or all of the PPA provisions impact the volatility of cost projections?

As a general matter, it is clear that the PPA's minimum funding requirements will increase the volatility of minimum required contributions. However, volatility is a concept that is distinct from predictability and FEI's Committee on Benefits Finance and Committee on Government Business believe that the PPA's provisions will provide contractors with the ability to somewhat better predict future volatility and therefore future costs. However, fair treatment of all parties will still require a mechanism that addresses potential windfalls or shortfalls resulting from the inability to predict precisely pension costs. These requirements and outcomes have been mandated by Congress through PPA for contributions contractors must make. Failure to harmonize CAS 412 and 413 will only exacerbate the volatility for the contractors and ultimately, for the government.

Question 7(a)(ii): Are there ways to mitigate this impact? Please explain.

As discussed above, the key issue is not volatility but rather predictability. FEI's Committee on Benefits Finance and Committee on Government Business believe that contractors will be able to model future costs under the PPA's minimum funding system and therefore budget for future costs.

Question 7(b): To what extent, if any, should the CAS assignable cost limitation be revised as part of the efforts to harmonize the CAS with the PPA?

After harmonizing with the PPA, the assignable cost limitation does not require further modification.

Question 7(c): To what extent, if any, should the CAS be revised to address negative pension costs in the context of cost volatility?

CAS pension costs should be funded and, as such, those costs should not be permitted to be below zero. In this regard, once funded, the contractor would be effectively unable to take a reversion under current law.

Question 8(a): To what extent, if any, would adoption of some or all of the PPA provisions affect the measurement of a segment closing adjustment in accordance with CAS 413.50(c)(12)?

The PPA funding target (determined without regard to the at risk rules) should be used as the segment closing liability under CAS 413.50(c)(12).

Question 8(b): To what extent, if any, should the CAS 413 criteria for a curtailment of benefits be modified to address the PPA mandatory cessation of benefit accruals for an "at risk" plan?

FEI's Committee on Benefits Finance and Committee on Government Business are of the opinion that the PPA mandatory cessation of benefit accruals for an "at risk" plan should not be subjected to the curtailment procedures under CAS 412 and 413.

Question 9(a): Should prepayment credits be adjusted based on the CAS valuation rate or the PPA requirement to use the pension fund's actual "return on plan assets" for the period?

Prepayment credits should be adjusted based on the pension fund's actual "return on plan assets" for the relevant period. This is one area where the PPA rules governing credit balances are appropriate to prepayments.

Question 9(b): Should the interest adjustment for contributions made after the end of the plan year be computed as if the deposit was made on the last day of the plan year or on the actual deposit as now required by the PPA?

Interest adjustments should be calculated based on the actual deposit, since that is the method used by the PPA.

Question 9(c)(i): To what extent, if any, should the CAS be revised to address the PPA provision that allows the recognition of established patterns of collectively bargained benefits?

CAS 412 and 413 should be revised to fully conform to the PPA provision permitting the recognition of established patterns of collectively bargained benefits.

Question 9(c)(ii): Are there criteria that should be considered in determining what constitutes an established pattern of such changes?

FEI's Committee on Benefits Finance and Committee on Government Business encourage the Board to adopt revisions fully conforming CAS 412 and 413 and the PPA with respect to the recognition of established patterns of collectively bargained benefits.

Question 10: The Board would be very interested in obtaining the results of any studies or surveys that examine the pension cost determined in accordance with the CAS and the PPA minimum required contributions and maximum tax-deductible contribution.

FEI's Committee on Benefits Finance and Committee on Government Business agree that this analysis should be an important aspect of developing revisions to CAS 412 and 413. To accomplish this goal, FEI's Committee on Benefits Finance and Committee on Government Business recommend that the Board tentatively resolve the major issues affecting harmonization in its deliberations prior to publishing an advanced notice of proposed rulemaking. By narrowing the range of possibilities, it will be much easier for industry to model the consequences associated with proposed revisions and thereby provide the Board with actionable information. Although FEI's Committee on Benefits Finance and Committee on Government Business understand the need for a rapid promulgation process in order to meet the effective dates imposed by section 106 of the PPA, sufficient time will be needed to complete a robust modeling effort. For this reason, once the Board publishes its initial thoughts on harmonization, FEI's Committee on Benefits Finance and Committee on Government Business recommend an extended comment period (*i.e.*, at least 120 days) to allow industry sufficient time to digest the proposed approach, undertake modeling, analyze the results of the modeling, and provide suitable feedback to the Board.

Question 11: In light of the changes to the PPA, should the Board consider including specific requirements in CAS 412 and 413 regarding the records required to support the contractor's proposed and/or claimed pension cost?

FEI's Committee on Benefits Finance and Committee on Government Business believe that any recordkeeping requirements that are required or useful under the PPA with respect to a contractor's proposed and/or claimed pension cost should be adopted by the Board in its harmonization of CAS 412 and 413 and the PPA.

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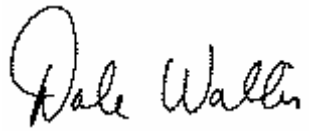
FEI's Committee on Benefits Finance and Committee on Government Business very much appreciate the opportunity to offer its comments with respect to the formation of the CAS Pension Harmonization Rule. FEI's Committee on Benefits Finance and Committee on Government Business look forward to ongoing conversations regarding this topic.

Sincerely,

Elliott Friedman
Chairman, FEI's Committee on Benefits Finance



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