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Cost Accounting Standards Board
Office of Federal Procurement Policy
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Washington, DC 20503

Attn: Laura Auletta

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We would like to thank the Cost Accounting Standards Board and its staff for the opportunity to comment on the issues related to harmonization of the Pension Protection Act (PPA) and Cost Accounting Standards (CAS) 412 and 413.

The Aerospace Corporation is a California, non-profit corporation that operates a Department of Defense (DOD) federally funded research and development center (FFRDC). Aerospace Corporation has a defined benefit pension plan that has over 2,000 active employee participants and 6,000 retired or terminated participants with vested pension benefits. The plan participants have earned their pension benefits, in most cases, over many years of service supporting the country's national defense space needs. Congress's goal in passing the PPA was to secure benefits for employees and retirees, like Aerospace's participants.

Aerospace is rather unique in its status as a non-profit corporation, operating a DOD FFRDC. Aerospace is reimbursed for its reimbursable costs, as allowed by the Federal Acquisition Regulations (FAR), Defense Federal Acquisition Regulations (DFARS), and CAS. In addition, Aerospace is allowed a "fee for need" based on Contracting Officer approval of cash flow needs to perform the services required by DOD agencies that are not reimbursable under FAR, DFARS or CAS.

Nearly 90% of Aerospace's revenue comes from work for DOD agencies with the remaining 10% of revenues primarily coming from other civil agencies such as National Aeronautics and Space Administration (NASA) and National Oceanic and Atmospheric Administration (NOAA). In all of these contracts, revenue is equal to reimbursable costs and fee for need, as defined by FAR, DFARS and CAS. Aerospace is not allowed to build up any reserves. If there are any excess funds generated from the small amount of work performed outside the DOD and civil contracts, these reserves will be used by the Contracting Officer to reduce the following year's fee for need. Fee for need is restricted and, the ability to use fee to make up any shortfall between CAS allowable reimbursements to our pension plans and the PPA required contributions, will likely be limited.

With this business model, the impact of failure to harmonize reimbursement requirements under CAS 412 and 413 to congressionally mandated (through the PPA) contributions to Aerospace's defined benefit plans is magnified. Where other defense contractors may have reserves generated from profits that can be used to make up for shortfalls caused by failure to harmonize, Aerospace does not have that luxury. With no reserves to cover shortfalls, Aerospace's business model serves as a clear illustration of the underlying impact failure to harmonize has on all DOD companies.

Even though Aerospace's revenues come almost entirely from contracts subject to FAR and DFARS regulations, Aerospace does not meet the definition of an "eligible government contractor" under Section 106 of the PPA, since our revenues are less than $5 billion annually. Since we do not qualify as an "eligible government contractor" we are subject to the requirements of the PPA in 2008. It is therefore of great significance to the Aerospace Corporation and to our DOD customers that CAS 412 and 413 not only be harmonized to the requirements of the PPA but that such harmonization occur sooner rather than later. It is also of significance, as discussed below, that harmonization be applicable to all government contractors, not just "eligible government contractors" as defined by the PPA.

The Aerospace Corporation's 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?

The Cost Accounting Standards have never had a separate set of rules for large contractors than for small contractors. There does not appear to us to be any rational logic for having two sets of rules in this case. If anything, the larger contractors have more resources and reserves to cover shortfalls between required contributions and reimbursement for those contributions than do the smaller contractors. A different, more lenient accounting rule for large contractors provides the large contractors with unfair, competitive advantages over smaller contractors. If separate rules are adopted for large contractors, those larger contractors will be able to get reimbursed for the PPA required costs more fully and quicker 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. The PPA does not provide for different levels for 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 requirements in the PPA. 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 the PPA -- improving plan funding and thereby providing greater assurance that plan participants will receive all their promised benefits and 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?

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. The Staff Discussion Paper discusses revisions made in 1995 to the original CAS 412 and 413 to address a conflict introduced by the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1987. Precedent has been established by the Board, and rightfully so, in the past to harmonize CAS 412 and 413 to congressionally mandated changes to required ERISA contributions. We believe the same should be done with the current congressionally mandated changes under the PPA.

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 ever 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?

The PPA allows a pension sponsor wide discretion in funding a plan. While required to make at least the PPA minimum contribution, a sponsor can choose to fund a much greater amount. Funding greater amounts can reduce ultimate pension costs and volatility. This wide discretion is provided to encourage sponsors to fund more than minimum amounts, thus further increasing benefit security and allowing sponsors to attain more predictable cash flows.

CAS rules have a different purpose – to promote uniformity and consistency among contractors. Uniformity and consistency is not enhanced by providing wide discretion in reimbursable costs. The Board should retain the concept of CAS 412 and 413 that provides a specific assignable cost for an accounting period. Contributions in excess of this amount should continue to result in prepayments and contributions less than this amount can be reimbursed to the extent previous prepayments are available.

CAS 412 and 413 should be revised to provide that the assignable cost for a period is the sum of the normal cost plus amortization subject to a minimum of the amount the sponsor is compelled to fund (the PPA minimum) and subject to a maximum of the maximum deductible contribution. Assignable cost for a period should never be less than the minimum required contribution and should never be greater than the maximum deductible contribution.

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

The CAS reimbursable cost should be determined without respect to ERISA credit balances. Volatility from year to year is inherent in the ERISA calculations. Management needs the flexibility to manage this volatility.

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

The measurement and assignment methods of the PPA reflect the evolution of thought concerning pension cost recognition. The PPA also reflects the compromises that are often necessary in the legislative process.

We urge the Board to adopt the basic measurement approach of the PPA. Specifically, this means measuring liability using the accrued benefit concept and market interest rates, or the "target liability" as it is called in the PPA. The cost of benefits earned during the accounting period should be the "target normal cost" as measured in the PPA.

The use of a single measurement and attribution method will enhance uniformity and consistency. The arbitrary choice of a cost attribution method as allowed under current CAS

rules and as originally allowed under ERISA should be eliminated to promote uniformity and consistency.

Use of a single method, if combined with using the same assumptions as the PPA, will provide the additional advantage of basing CAS and the PPA calculations on the same fundamental measurements of liability and cost. The liability and normal cost would be the basic building blocks of determining the CAS reimbursable cost. This would promote efficiency and help eliminate errors.

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

The Staff Discussion Paper discusses revisions made in 1995 to the original CAS 412 and 413 to address a conflict introduced by the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1987. Precedent has been established by the Board, and rightfully so, in the past to revise CAS to agree to changes in tax policy. We believe the same should be done with the current congressionally mandated changes under the PPA.

For years there has been a debate as to how much Financial Accounting Standards and Cost Accounting Standards should be driven by tax policy and legislation. There is clearly different purposes between tax policy and accounting standards. However, in this case, the accounting standard (for CAS purposes) directly impacts a company's ability to meet the mandates required under tax legislation. More clearly, tax related legislation is dictating a change in the amount of contributions that a company must make to its pension plans. The Cost Accounting Standards dictate the reimbursement the company can receive for this congressionally mandated contribution.

Companies do not have the option of selecting the approach they believe may be the "best" theoretical accounting approach. The federal government, through congressionally mandated PPA requirements, has selected the approach that must be followed for contribution purposes. If CAS 412 and 413 are not harmonized, the CAS Board is saying it disagrees with the approach mandated by congress and may not permit companies to be reimbursed for congressionally mandated, required contributions.

We are not suggesting that CAS should replicate the PPA; but that CAS should follow the same basic approach and use the same basic assumptions as the PPA. In our opinion, this is what harmonization requires.

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?

The Board should be aware that failure to harmonize may cause smaller contractors and non-profit contractors, like Aerospace, to run a greater risk that their plans will have to be turned over to the PBGC. It would be ironic if congress's attempt to protect pensions with the passage of the PPA was offset by the failure of those pension plans because of CAS 412 and 413 not being harmonized to the PPA.

Turning the pension liabilities over to the PBGC ultimately has a greater cost to the government and harsher impact on the participants than does revising CAS 412 and 413 provisions to allow for more effective management of the plans on an on going, long term basis.

> **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?**

One can debate whether the PPA's settlement or liquidation approach to valuing pension plan assets and liabilities is preferable to the going concern approach utilized currently by CAS. While there are arguments for either approach, the current requirements mandated by Congress and the financial reporting requirements mandated by the Financial Accounting Standards Board (FASB) take the settlement or liquidation approach. For CAS to fail to adopt this same approach, puts the CAS accounting out of synchronization with other currently required reporting and accounting requirements for pension plans.

> **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?**

The Board should revise CAS 412 and 413 to adopt the same assumptions as to interest rates, future salary growth and mortality tables as used in the PPA. These variables have a tremendous impact on the measure of the liability at any point in time. For consistency in required contributions and in reimbursement for those contributions, the same assumptions should be used.

For contract cost measurement, the contractor does need the flexibility, to manage future volatility, to measure cost for CAS in an amount that will never be less than the amount the sponsor is compelled by the PPA to contribute nor more than the maximum deductible contribution provided by the PPA.

> **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?**

CAS 412 and 413 should utilize the same interest rates that are adopted by the PPA. Strong arguments can be made that the PPA required interest rates are too low or even that they are too high. But in any case, they are clearly defined based on assumptions mandated by the PPA.

Even a few basis points difference in the interest rate assumptions can make a huge difference in the amount of liability calculated at any point in time and, of course, the related amount of contributions needed to achieve required funding. For CAS to use interest rate assumptions that are significantly different from the PPA assumptions results in PPA required contributions significantly different from CAS provided reimbursements of those contributions. Also, using the more subjectively selected interest rate assumptions under current CAS 412 and 413 provides less uniformity amongst similar contractors.

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. If the contractor's investment policy consistently achieves results better than the PPA assumed rates, the cost and volatility will be reduced for the contractor and for the government because of increased value in the assets being used to fund the liabilities at plan measurement dates.

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. We believe CAS 412 and 413 should take a similar approach; although this does not have as significant an impact on plan sponsors as does differences in interest rates, mortality tables and amortization period assumptions.

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.

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?

The Board should 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)?

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?

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 Board should not provide special rules for "at risk" plans.

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 the PPA minimum funding requirements exceeding assignable costs under the current CAS 412 and 413.

There is an argument that the difference between the PPA and current CAS 412 and 413 is merely a timing difference and that the timing difference will turn around at some future date. For example, if a company is required to contribute more in one year than it will be reimbursed under CAS, that there will be a prepayment that will be recovered at some future date. There are two problems with this argument. First, this will be true at some future date, but in an on going plan, with normal cost increases each year, that future date may be decades in the future. Secondly, for a company like Aerospace, where there are no reserves to make prepayments, even a prepayment of two or three years will cause the company to not be able to make its PPA required contributions, forcing the plans to be terminated.

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. These requirements and outcomes have been mandated by Congress, through the PPA, for contributions contractors must make. If CAS 412 and 413 do not allow for reimbursement for more than the minimum funding requirements under the PPA; the contractor is unable to develop a contribution strategy that will minimize this volatility, like is done under pre-PPA and existing CAS. CAS 412 and 413 harmonization needs to provide the flexibility to contractors to permit a contribution strategy over the long term that will minimize volatility for both the contractor and the government.

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

The Board should adopt a symmetrical method of cost recognition. The assignable cost for a period should be defined as the target normal cost plus a 7 year amortization of the difference between the target liability and the plan assets (adjusted for prepayments). If a plan has a surplus, the assignable cost should be the target normal cost less a 7 year amortization of the surplus. The assignable cost will be zero only if the 7 year amortization of surplus exceeds the target normal cost. This symmetric treatment of deficits and surplus will greatly mitigate volatility of assignable cost.

Volatility could be further reduced by adopting a Volatility Limit. A Volatility Limit would limit the change in the assignable cost from one period to the next by a Maximum Allowed Change based on the previous year normal cost or target liability.

Aerospace, like many companies, is looking at a Liability Driven Investment (LDI) strategy to further mitigate the impact of the PPA changes. Such a strategy is easier to implement and easier

to manage if we are working with similar rules and similar assumptions for both the PPA required contribution calculations and the CAS reimbursement requirements.

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 should never be greater than the maximum deductible contribution or less than the amount the sponsor is compelled, by law, to fund.

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)?

No comment.

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?

No comment.

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?

No comment.

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

No comment.

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.

Aerospace's contribution to our defined benefit plan has been in the $40 million per year range since coming out of full funding in 2001. Aerospace has been fortunate since 2001 in that our reimbursable cost has been within the ERISA limits and within the range of CAS allowable reimbursements. Using the overlapping contribution and reimbursement limits, we developed a contribution strategy that has enabled us to manage the volatility of our plan from year to year since 2001. However, this will not continue under the PPA without CAS harmonization. Our ability to manage the volatility will be taken away. The inability to manage the volatility will create isolated years when our contribution requirement will exceed our CAS reimbursement forcing us to take draconian measures in our plan design or even plan existence; the exact opposite of the Congressional intended "pension protection".

Our outside actuaries have run projections on the impact the PPA will have on Aerospace, if CAS 412 and 413 are not harmonized. The PPA will increase the amount of contributions that Aerospace must make, beginning in fiscal year 2008. If CAS is harmonized to the PPA, we can continue our contribution strategy to spread these increases over future years in a way that is least volatile to our company and to our DOD customers.

By 2010, if CAS 412 and 413 are not harmonized to the PPA, thus preventing us from following our current contribution strategy, at a median investment return, Aerospace will be required to contribute $20 million more than what the company will be reimbursed for under CAS. Over the next six years, at the median, that shortfall will increase to a total of $154 million.

Even at a 75% favorable return on investments, by 2011 the shortfall will be $10 million, increasing to a total of $100 million by 2015.

Only at the 95% favorable return on investments is Aerospace able to be reimbursed each year under the current CAS for the contributions required under the PPA.

If CAS 412 and 413 are not harmonized and if Aerospace does not experience the 95% best case return on investments, it is highly likely Aerospace will have to freeze or significantly curtail the defined benefit plans earned by its employees by 2012.

We will be glad to provide more detailed information and discussion to the Board to help the Board with its understanding of the draconian impact failure to harmonize will have on Aerospace's defined benefit plan and the negative impact it will have on our plan participants.

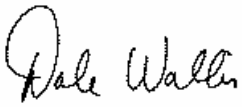
Question 11: In light of the changes to the PPA, should the Board consider including specific requirements in CAS 412 and 413 regarding the records required to support the contractor's proposed and/or claimed pension cost?

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.

* * *

We very much appreciate the opportunity to offer our comments with respect to the formation of the CAS Pension Harmonization Rule. We look forward to ongoing conversations regarding this topic.

Sincerely,



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