2006-2007

CHAIR
Michael A. Hordell
600 14th St, NW, 6th Flr
Washington, DC 20005
(202) 220-1232

CHAIR-ELECT
Patricia A. Meagher
582 Market St, Ste 301
San Francisco, CA 94104
(415) 362-6517

VICE-CHAIR
Michael W. Mutek
1200 S Jupiter Rd
Garland, TX 75042
(972) 205-5177

SECRETARY
Karen L. Manos
1050 Connecticut Ave, NW, 2nd Flr
Washington, DC 20036
(202) 955-8536

BUDGET AND FINANCE OFFICER
Carol N. Park-Conroy
7404 Rippon Rd
Alexandria, VA 22307
(703) 681-8507

SECTION DELEGATES
John S. Pachter
8000 Towers Crescent Dr, Ste 900
Vienna, VA 22181
(703) 847-6260

Mary Ellen Coster Williams
717 Madison Pl, NW, Ste 612
Washington, DC 20005
(202) 357-6660

IMMEDIATE PAST CHAIR
Robert L. Schaefer
12333 W Olympic Blvd
Los Angeles, CA 90064
(310) 893-1609

PREVIOUS PAST CHAIR
Patricia H. Wittie
818 Connecticut Ave, NW, Ste 1100
Washington, DC 20006
(202) 496-3493

COUNCIL MEMBERS
Jennifer L. Dauer
Sacramento, CA

Daniel F. Doogan
Detroit, MI

David G. Ehrhart
Dayton, OH

Paul B. Haseman
Aurora, CO

E. Sanderson Hoe
Washington, DC

David F. Innis
San Francisco, CA

Sharon L. Larkin
Washington, DC

Stuart B. Nibley
Washington, DC

Scott E. Pickens
Washington, DC

Richard P. Rector
Washington, DC

Jeri K. Somers
Washington, DC

Angela B. Styles
Washington, DC

Holly Emrick Svetz
McLean, VA

EDITOR, PUBLIC CONTRACT LAW JOURNAL
Karen L. Manos
Washington, DC

EDITOR, THE PROCUREMENT LAWYER
Mark E. Langevin
Los Angeles, CA

BOARD OF GOVERNORS LIAISON
Charles A. Weiss
St. Louis, MO

SECTION DIRECTOR
Marilyn Neforas
321 N Clark St, M/S 19.1
Chicago, IL 60610
(312) 988-5596

AMERICAN BAR ASSOCIATION

Section of Public Contract Law
Writer's Address and Telephone

September 4, 2007

VIA ELECTRONIC AND U.S. MAIL

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. Staff Discussion Paper Regarding Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006, 72 Fed. Reg. 36508 (July 3, 2007).

Dear Ms Auletta:

On behalf of the Section of Public Contract Law of the American Bar Association (the Section), I am submitting comments on the above-referenced Staff Discussion Paper (SDP). The Section consists of attorneys and associated professionals in private practice, industry and government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.[1]

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.[2]

---

[1] Mary Ellen Coster Williams, a Council member of the Section of Public Contract Law, did not participate in the Section's consideration of these comments and abstained from the voting to approve and send this letter.

[2] This letter is available in pdf format at: http://www.abanet.org/contract/Federal/regscomm /home.html under the topic "Cost Allowability and Cost Accounting."

Comments

By Federal Register notice published on July 3, 2007, the Cost Accounting Standards Board (Board) requested public comments concerning a SDP on the harmonization of Cost Accounting Standards (CAS) 412 and 413 with the Pension Protection Act of 2006 (PPA). In particular, the Board seeks comments on eleven questions related to the harmonization. The following responds to those questions that have policy or legal implications, but not to the questions that relate exclusively to actuarial or other issues beyond our expertise.

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?

Answer: Yes to the former. There is no reason to treat "eligible" contractors differently from other contractors. In measuring pension costs, there is no justification for treating large contractors differently from smaller contractors, for treating DOD contractors differently from DHS, DOE, or HHS contractors, or for treating companies that derive all of their revenue from government business differently from companies that derive less than 50 percent of their revenue from government business. In addition, as contractors move in and out of the "eligible" category, the problems caused by adapting to different rules could be enormous. Applying the same rule to all CAS-covered contractors would also further the CAS Board's stated goal of uniformity and consistency in cost accounting practices and should simplify the Federal Acquisition Regulation (FAR) Council's process of aligning the FAR cost principles with CAS.

Question 2: Do the current CAS 412 and 413 substantially meet the Congressional intent of the PPA to protect retirement security and to strengthen funding and ensure Pension Guarantee Benefit Corp. solvency?

Answer: No. The current CAS 412 and 413 provisions do not meet the Congressional goal to protect retirement security, or ensure PBGC solvency. Further, the CAS may undermine efforts to strengthen pension funding. Congress has dictated the amount that is required to accomplish the intent of the PPA. Most contractors will be required to comply with the minimum funding requirements mandated by Congress starting in 2008; by 2010 all contractors will be required to comply with those requirements. There is nothing the Board may do or is authorized to do to change the amount that contractors will be required to contribute. The question for the Board is whether the CAS should be changed so that the Government is required to recognize its fair share of the obligations that it

has imposed on contractors under the PPA in the same year the contractor is required to meet those obligations. If CAS 412 and 413 are not revised to recognize the contributions required by the PPA, the standards will not be consistent with the intent of the statute.

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?

Answer: The statute directs the Board to harmonize the minimum funding requirements of PPA and the requirements of CAS 412 and 413. The Board is not prohibited from taking this opportunity to make other needed changes to the standards, but it is not required to do so. It is required only to revise the standards to the extent necessary to make the standards consistent with the PPA minimum finding requirements.

The Board may need to address transitional issues including the treatment of CAS prepayments created by contractors meeting PPA minimum funding requirements, the treatment of PPA minimum funding costs allocated to fixed-price contracts, and segment closings occurring shortly after the CAS harmonization rules are adopted.

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?

Answer: Assuming that the PPA minimum funding requirement exceeds CAS requirements, the answer to this question is yes. The Section believes that this is the reason why Congress required the Board to harmonize CAS with the PPA requirements.

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? [*see* Question 3(d)(1), below]

Answer: As explained more fully below, the Section recommends that the Board adopt the PPA minimum funding requirement as the baseline cost for government contract cost accounting purposes, subject to appropriate limits to control volatility. The revised standards should permit contractors to recognize amounts in excess of the minimum contribution for costs up to the maximum tax-deductible contribution in some circumstances, at least including when the contracting parties agree. The

Board should also address other circumstances where permitting something more than the minimum contribution makes sense, including, for example, contributions to a plan that covers primarily commercial business where the Government would reimburse only a minor portion of the contribution. By adopting the PPA minimum funding requirements, the Board would be achieving uniformity and consistency in pension cost accounting practices because all contractors would be compelled to meet the same requirements.

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

Answer: If the Board does not accept the Section's recommendation to use the PPA minimum funding amount as the baseline for determining pension costs for government contract cost accounting, it should consider how to treat credit balances generated by compliance with the PPA. There is a considerable difference between the treatment of prepayment credits and amortization of various differences under CAS and that required by the PPA. If the Board uses another approach for determining the allocable cost, these differences will need to be reconciled. The exact manner of the reconciliation will depend on other choices that the Board will make.

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

Answer: As indicated below, the Section recommends that the Board accept the PPA minimum funding amount as the baseline for determining pension costs for government contract cost accounting. If the Board adopts that recommendation, the costs would be determined based on the calculations required by PPA, subject to any amortization of PPA costs that is necessary in order to avoid unacceptable volatility.

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

Answer: The Section does not suggest that the Board adopt accounting rules from the tax code. *See* Question 3(b), above. Instead, the Section recommends that the Board recognize that a cost imposed on contractors by federal law should be recognized as a cost in the year that federal law requires the cost to be paid. Further, the PPA only requires that the minimum funding be harmonized. The Board has multiple accounting options with regard to funding in excess of the minimum required amount. From a practical standpoint the minimum funding is a real cost to a contractor because it is a payment dictated by law. This is similar to

the cost of state income taxes, which is a real cost based on a state statutory calculation.

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?

Answer: The Board should comply with the Congressional direction to harmonize CAS with the PPA. In the considered view of the Section, the Board has no responsibility to consider the solvency of pension plans or the PBGC, except to the extent that compliance with the harmonization requirements of the statute would contribute to those goals.

Question 4: (a) Accounting Basis. 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?

(b) Actuarial Assumptions. For contract cost measurement, should the Board

(i) Continue to utilize the current CAS requirements that 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?

(c) Specific Assumptions. Please comment on the following specific assumptions:

(i) Interest Rate:

(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?

(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?

(ii) Salary Increases: For measuring the pension obligation, should the CAS exclude, permit or require recognition of future period salary increases?

(iii) Mortality: 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?

(d) Period Assignment (Amortization). 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 7 year period consistent with the PPA minimum required contribution computation, or

(iv) adopt some other amortization provision?

(e) Asset Valuation.

(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)?

(ii) For contract cost measurement, should the Board adopt the PPA's two year averaging period for asset smoothing?

Answer: The Section expresses no views on the specific actuarial issues raised in this question. It is noted, however, that if the Board adopts the Section's recommendations on the other questions, this question is moot. The CAS would simply recognize the costs required by PPA as the baseline cost for contract accounting purposes. In the event that the Board adopts recognition of costs in excess of minimum funding, there would be a need for the kind of provisions contemplated by this question. If costs in excess of minimum funding are not recognized, then no additional provisions would be required.

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?

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

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

Answer: Under the Section's recommendations as stated in this letter, these cash flow issues would be eliminated, except to the limited extent that the Board determines that amortization of the PPA required funding is necessary to control volatility, discussed in the next section.

***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?

(ii) Are there ways to mitigate this impact? Please explain.

Answer: The Section expresses no view on whether adoption of some or all of the PPA provisions will impact the volatility of cost projections, although it is aware that many actuaries have expressed the opinion that volatility will increase. As suggested in one of the Board's other questions, the Board needs to develop empirical data on that issue. If there is evidence that volatility could become a serious problem for at least some contractors, the Section recommends that the Board either permit or require the amortization of the PPA requirement when volatility exceeds certain thresholds. For example, assume that a contractor has priced its contracts based on an estimate that pension costs will total $100 million (M) in a given year and that the regulations either permit or require that any variation from that amount that exceeds some fixed percentage of the estimate – say 10 percent – would be amortized over some fixed period. If the contractor incurs between $90M and $100M in costs, there would be no amortization. If the contractor incurs $70M in costs and the amortization period is 5 years, it might be

required to report costs of $90M in the year of the estimate and reduce its pension costs by $4M (($90M - $70M) / 5 = $4M) in each of the following 5 years. If the actual cost is $130M, the contractor would report $110M in that year and increase pension costs by $4M (($130M - $110M) / 5 = $4M) in each of the following five years.

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?

Answer: The Section responds by noting that this question will be irrelevant if its recommendation to Question 7(a) is adopted by the Board.

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

Answer: As indicated in the example above, amortization could be used to dampen volatility in both directions.

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 or claimed pension cost, or both?

Answer: This question reflects one of the best reasons to use the PPA requirements as the baseline for government contract accounting. For the past thirty years, contractors have been required to calculate pension costs for financial reporting purposes, for tax purposes, and for CAS/FAR purposes. The differences among those calculations have caused confusion and disputes among contractors, government auditors and contracting officers. There is no reason to continue to require contractors to calculate a "cost" that is different from the amount they are legally obligated to contribute, or to maintain records and perform calculations that have no relationship to that legal obligation.

Conclusion

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as the Board may require

as it proceeds with its important work to harmonize Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006.

Sincerely,

Patricia A. Meagher
Chair, Section of Public Contract Law

cc: Michael W. Mutek
Karen L. Manos
Donald G. Featherstun
Carol N. Park Conroy
Council Members, Section of Public Contract Law
Chair(s) and Vice Chair(s) of the Accounting, Cost and Pricing Committee
Scott M. McCaleb