NORTHROP GRUMMAN

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

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

Reference: CAS-2007-02S

Dear Ms Laura Auletta

Northrop Grumman Corporation (NGC) is pleased to offer its comments to the Subject Staff Discussion Paper pertaining to CAS Harmonization with the Pension Protection Act (PPA). NGC has actively participated in the generation of the comments provided by Independent Actuaries and has reviewed the comments provided by the American Bar Association. NGC fully supports the comments outlined in these documents and strongly endorses the conclusion that CAS 412 and 413 should be fully harmonized with the PPA. NGC has also actively participated in the generation of the Aerospace Industries Association (AIA) comments and generally supports the positions contained in this document.

NGC's support of the harmonization of CAS 412 and 413 with the PPA is based on the principle that the pension costs it incurs in compliance with ERISA minimum funding requirements should be reimbursed to the Company on a timely basis.

NGC believes it is important for the CAS Board to recognize the serious dilemma presented by PPA for the defense industry and the US Government. Both NGC and the defense industry as a whole will face significant cash flow problems should the CAS not be fully harmonized with PPA including its minimum pension funding requirements. Absent full harmonization, these negative cash impacts could seriously harm industry and adversely affect a company's decision to continue providing pension benefits to employees. NGC does not believe such outcomes were intended by Congress and highlights the urgent need to harmonize CAS 412 and 413 with PPA on a timely basis. NGC believes that expeditious harmonization is even more critical to the economic viability of our subcontractors, most of who do not qualify for the deferral of minimum funding requirements available to eligible Government contractors.

NGC's preliminary assessment shows that the budget and potential budget related schedule impacts of CAS harmonization will affect literally thousands of its "firm" and "potential" fixed price and flexibly priced contracts. Such impacts <u>were not</u>, and <u>are not</u> currently included in the business assumptions used in pricing and negotiation of existing and other pre-harmonization contracts. These effects should be strategically managed and thoughtfully considered by the CAS Board in its harmonization efforts to avoid negative impacts to the defense industry and

our US Government customers while at the same time establishing sound cost accounting practices.

To this end, in addition to the response/answers provided by Industry experts to the questions in the Staff Discussion Paper, NGC takes this opportunity to emphasize the following additional points which it considers key in the harmonization of CAS 412 and 413 with PPA.

Positions NGC would like to emphasize as particularly important pertaining to questions raised in the Staff Discussion Paper:

- Full Harmonization at the Conceptual Level NGC urges the CASB to adopt full harmonization of CAS 412 and 413 with respect to the definition and measurement requirements of PPA, by adopting the PPA actuarial assumptions for CAS measurement purposes. The adoption of the seven year amortization for cost measurement consistent with PPA is, in NGC's opinion, one of the most critical assumptions of CAS harmonization. Further, NGC believes the term "building blocks" as used in the Independent Actuaries letter is apt. The basic rules of "harmonized CAS" should be the same concept as for the PPA. As part of CAS harmonization, consideration must be given for transition rules and provisions for smoothing. These provisions will mitigate the greatly increased volatility of required funding inherent in PPA and inherent differences in plan assets resulting from prepayment credits.
- Expeditious Rule Making The uncertainty and near term financial impact on companies, particularly those which are not "eligible defense contractors" resulting from CAS harmonization, are significant, material, and it is critical these impacts be addressed now. As contractors move closer to calendar year 2010, there will be increasing pressure from internal and external customers, as well as suppliers to include the impacts of CAS harmonization into rates and factors in proposals for contracts having performance periods in years beyond calendar year 2010. Therefore, NGC strongly recommends the CAS board expend its best efforts to expedite completion of its promulgation efforts for CAS harmonization. Such expedited actions will mitigate potential funding issues for our Government customers and minimize financial issues during contract performance. As previously noted, NGC believes that its subcontractors, largely companies that do not qualify as eligible defense contractors, should be carefully considered in timing the rulemaking process to ensure viability of the defense industry at all levels.
- "Pension Stabilization Accounts" (as described in the comments provided by the Independent Actuaries), We urge the CAS Board to incorporate the concept of the "pension cost stabilization account" or a similar process in order to address the issue of pension expense predictability on fixed priced contracts in the post CAS harmonization environment. This will be particularly important given the increased volatility inherent in any harmonization of CAS 412 / 413 with the PPA.
- Curtailment of Benefits The CAS Board should consider a curtailment of benefits as a plan amendment rather than a segment closing in the situation where the contractor's business and contracts are ongoing.
- Prepayment Credits NGC believes consideration should be given to enable contractor recovery of existing prepayment credits within a reasonable period after CAS harmonization.

Other critical issues the CASB should address as part of CAS harmonization not specifically identified with the questions outlined in the Staff Discussion Paper:

- Cost Accounting Practice Changes All contractors with defined benefit pension plans will be required to change their cost accounting practices as a result of the CAS Board's actions to harmonize CAS 412 and 413 with PPA. NGC believes that all such cost accounting practice changes should be treated as a single and required cost accounting practice change with entitlement to equitable adjustment notwithstanding any implementation options selected by the CAS Board.
- **"**Cost of Money**"** In the event full and immediate CAS harmonization does not occur, we urge the CAS Board implement a factor analogous to cost of money to funded PPA costs where they are deferred for CAS purposes.

Due to the potentially material and significant impact CAS harmonization will have on contractors and the US Government and the as yet largely undefined scope of the eventual harmonization, NGC recommends the CAS Board call a public meeting to discuss the status of harmonization and its preliminary assessment of respondent inputs to the Staff Discussion Paper prior to issuing any formal findings or proceeding onto its next step in the rulemaking process.

Please do not hesitate to contact me should you have any questions on the above.

Sincerely,

Susan L. Coté
Vice President,
Corporate Contracts,
Pricing & Supply Chain