August 31, 2007

Cost Accounting Standards Board
Attention: Laura Auletta
725 17th Street, NW
Room 9013
Washington, DC 20503

Reference case CAS-2007-02S

We want to thank the Cost Accounting Standards Board for recognizing the value of industry comments at this point in the harmonization process for CAS 412 and 413. In support of your request, we are submitting this response letter.

Industry believes that for the CASB to achieve harmonization as mandated by Congress, the revisions to CAS must generally rely on the calculations of the minimum required contribution of PPA. We recognize the discomfort of accepting this, as the PPA calculations create an exposure to volatility. However, we believe the CASB has options available to mitigate these volatilities in ways that fairly and equitably balance the needs of both Government and contractors while satisfying the mandate for harmonization. We also believe that it is imperative the CASB consider temporary transitional rules to smooth any abrupt change in costs as a result of implementation of revised CAS. We recommend that these transitional rules be eliminated as of an established date when pension costs would be expected to stabilize under the new CAS provisions.

As members of industry, we are aware that the circumstances of each Government contactor with a defined benefit pension plan bring a unique perspective and set of concerns to this harmonization effort. Those circumstances include current pension plan funding levels, existing cumulative assignable cost deficits or prepayment credits, shifting contract mixes, implementation or deferral of the PPA funding requirements, and the like. However, we all share some of the same concerns. How much cash will be needed for our minimum required contribution under PPA—immediately and ongoing? What impact will this cash outlay have on the financial capabilities of our business, including our ability to maintain operational cash flow to perform on Government contracts? What other plans may we have to sacrifice to get the cash needed immediately? How will the harmonization of CAS impact costs reimbursed through contracts and when? We understand that the Government has analogous concerns to ours. How much cash will be needed to pay contractors—immediately and ongoing? What impact will this cash outlay have on other planned expenditures? How will the harmonization of CAS impact costs paid through contracts and when? It is important that the CASB understand and consider the concerns of all interested parties in the process of harmonizing CAS.

As with most complex and difficult regulatory challenges, we do not expect harmonization to cure every conceivable ill, nor address every contractor's unique circumstances or the Government's with perfection. However, across industry there is the expectation that the CASB will execute this assignment in accordance with its objectives, as published in the Federal Register (July 13, 1992), which includes the design of fair and equitable standards that show neither bias nor prejudice to either the contractor or the Government. We encourage the Board to continue to ask questions to obtain information and data, develop an understanding of the multifaceted issues from all perspectives, and consider alternatives available. In support of these significant efforts of the Board, industry will continue to provide appropriate information and data as requested.

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 contractors" as defined in Section 106?

Any revisions to CAS 412 and 413 should apply to all contractors. CAS 9901-302(b) states that the cost accounting standards are "designed to achieve uniformity and consistency in cost accounting practices governing measurement, assignment, and allocation of costs to contracts with the United States Government." Promulgation of a revised standard applicable to only a portion of the contractors covered by CAS would be contradictory to achieving uniformity and consistency. There would be differences between contractors based on their individual status of eligibility affecting consistency. There could also be differences for a single contractor's eligibility across cost accounting periods due to changes in the balance of Government and commercial work performed, as programs turnover and acquisitions or divestures are made by the company, which would affect uniformity.

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?

We believe the current CAS 412 and 413 do not meet the Congressional intent of the PPA. More importantly, Congress would not have required the CASB to revise these standards if Congress believed them to already meet their intent with PPA.

The Board may be considering whether the "harmonization" of CAS with PPA means the standards should be designed "to protect retirement security, to strengthen funding and ensure PBGC solvency", and furthermore, the Board may be considering if the existing CAS 412 and 413 are already so designed. We

disagree with this interpretation of the harmonization requirement, and even if such an interpretation were assumed, we disagree that the standards are already so designed.

The interpretation of "harmonization" implied by this question is one of alignment with the intentions of PPA rather than with the calculations of PPA. This interpretation is inconsistent with the language in Section 106 of the PPA which requires revision of CAS "to harmonize the minimum required contribution under the Employee Retirement Income Security Act of 1974 [ERISA] of eligible contractor plans and government reimbursable pension costs…" It is clear to us that Congress intends this harmonization to generally be of the mathematical calculations of the ERISA minimum funding and the CAS pension costs. Of course, to harmonize the calculations may likely achieve alignment of the intentions described as well.

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?

We believe the Board should focus only on the relationship of the PPA minimum required contribution and the contract costs in accordance with CAS 412 and 413 during their harmonization effort. Section 106 of the PPA states very clearly that the Board is to revise CAS 412 and 413 "to harmonize the minimum required contribution under the Employee Retirement Income Security Act of 1974 and the government reimbursable pension plan costs..." There is no mandate for harmonization beyond the minimum required contribution or with any other amount.

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?

The penalty for contractors due to the differences between ERISA and current CAS is the result of increased contributions required by the PPA and the inability under current CAS to receive timely cost reimbursement of those funds. While this is not a statutory penalty, it is certainly a punishment to contractors doing business on a CAS covered basis with the Government.

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?

As we stated in our answer to question 3, we believe the Board should focus on the relationship of the PPA minimum required contribution and the contract costs in accordance with CAS 412 and 413 during their harmonization effort. Section

106 of the PPA states very clearly that the Board is to revise CAS 412 and 413 "to harmonize the minimum required contribution under the Employee Retirement Income Security Act of 1974 and the government reimbursable pension plan costs..." However, we do recommend that the Board consider retaining the concepts of assignable cost credit and assignable cost deficit that are likely to address the Board's concerns implied by this question.

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

ERISA credit balances are the funded amounts in excess of the minimum funding required by ERISA. Contractors may choose to contribute more funds in the current year to reduce funding requirements in subsequent years. The analogous concept in CAS is prepayment credits, which are the funds in the pension plan in excess of cumulative pension costs. However, an important difference between CAS prepayment credits and their ERISA credit balance kin is that the CAS prepayment credits can have no affect on the amount of pension cost calculated in future years, which is desirable to achieve uniformity and consistency in CAS pension cost calculations.

Moreover, the ability of a contractor to influence pension costs charged to Government contracts simply by creating an ERISA prefunding balance in a pension plan is contrary to the Board's purpose of designing standards for uniformity and consistency, so we don't recommend the Board consider harmonizing the concepts of CAS prepayment credits and ERISA credit balances.

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

We believe that for purposes of meeting the harmonization requirement in PPA, CAS 412 and 413 should essentially be based on the minimum required contribution calculations.

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

Though the Internal Revenue Code is referenced in the PPA, Section 106 of the PPA specifically requires harmonization of CAS 412 and 413 with the minimum required contribution under PPA not tax policy. We believe the Board should limit its revisions for CAS based on tax policy to considering retention of the assignable cost deficit provision in the existing CAS.

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?

We believe that the PPA addressed any solvency concerns related to pension plans and the PBGC.

Question 4(a). For Government contracting 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?

We recommend that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA. We understand this requires a move away from the overly optimistic long-term view of current CAS, but we disagree that harmonization with PPA is synonymous with accepting a liquidation or settlement basis. In fact, the PPA methodology is somewhere between the current CAS and a liquidation (or settlement) approach.

The PPA methodology is a market-based measurement. Aspects of the calculation are consistent with treatment of costs on a going concern basis. For example, PPA requires a 7 year amortization period for any unfunded liability. Use of such an amortization feature is evidence that the calculation is not intended to establish a liquidation (or settlement) amount. The use of a market-based approach has been widely adopted across accounting disciplines (United States Financial Accounting Standards Board and International Accounting Standards Board among others) as the accepted measurement for pension costs. We believe a market-based approach for CAS is appropriate and is likely to be achieved through harmonization with PPA.

Question 4(b). For contract 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?

We recommend option (ii), using the PPA minimum required contribution assumptions. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of 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?

We recommend using the rate curve specified by the PPA. This would achieve consistency and uniformity between contractors greater than exists today under current CAS. It would also provide the best basis for matching costs to the benefits earned as the intent of PPA, as we understand it, is to secure the cumulative benefits earned by participants as of each accounting period; thus, the use of the rate curve under PPA measures pension costs from the perspective of the current accounting period's facts and data, rather than those assumed to occur over many years into the future. We believe the PPA approach is generally accepted to have better cost attribution to accounting periods as a result.

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?

We recommend using the rate curve approach specified by the PPA. This would achieve consistency and uniformity among contractors and is in accordance with our recommendation of achieving harmonization by essentially basing the calculations for CAS on those of PPA.

Contractor's investment policies and investment mixes, given the generally accepted goal to minimize the risk to pension assets, are not likely to be significantly different. This investment strategy will certainly be reinforced by PPA to mitigate the volatility of potential funding requirements.

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

We recommend excluding future salary increases consistent with the PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

We would not recommend permissive recognition of salary increases because this would undermine consistency among contractors.

Question 4(c)(iii). For measuring the pension obligation, should 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?

We recommend using the same mortality table that the contractor uses for PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

While PPA does allow companies to use a company-specific table, we believe their use is likely to gain little, if any, accuracy, and differences in company-specific mortality tables between contractors are probably minimal.

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 7 year period consistent with the PPA minimum required contribution computation, or (iv) adopt some other amortization provision?

We recommend that option (iii), the fixed 7 year amortization period, should be the starting point for the Board during its harmonization efforts. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of 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 10%) of the market value?

We recommend that using the 90% to 110% corridor range specified in the PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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

Based on our proposal, we believe that the two year averaging period for asset smoothing used by PPA should be the starting point for the Board during its harmonization efforts. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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

Plan funding requirements have been established by ERISA, so we do not believe the Board needs to include any revisions for funding rules of "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?

We believe that Section 106 of the PPA is evidence that Congress understands the seriousness of the potential cash flow challenges imposed by the PPA on Government contractors and intends the CASB to address theses issues by mandating harmonization of CAS 412 and 413 with PPA.

The potential cash flow concerns to Government contractors result from the inability of these companies to adjust their prices unilaterally to recover the additional cash outlays on a timely basis, as commercial enterprises have the option to do. Pension costs for Government contracts must comply with CAS, leaving contractors pinched between current CAS and PPA requirements. We also recognize that if a contractor's cash flow is impacted severely enough, the contractor may choose to terminate the pension plan, settle up all benefit obligations, and claim the resulting cost. This would certainly be contrary to securing such benefits for employees intended by Congress in passing the PPA, so it is logical that Congress would include the harmonization requirement to avoid such undesirable consequences.

We believe harmonization of CAS with PPA would provide fairness and equity to both the Government and contractors, as Congress intended, and meets with the CASB objectives.

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

The prepayment provisions in current CAS do allow a contractor to ultimately recover their pension contributions made in excess of CAS assignable costs. However, this recovery may be so many years into the future as to be essentially nonexistent. Moreover, with the implementation of PPA funding requirements, the frequency and amount of contractors with prepayment credits is likely to increase significantly, so the delayed cost recovery will be far more of an issue than currently exists. While we believe the concept of prepayment credits should be retained in the revised CAS, there is no doubt that such a mechanism alone is woefully inadequate in meeting the objectives of Congress in harmonization.

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

We recognize that the objective of prepayment credits is to provide for equity between the Government and contractor. The Government is protected from a contractor funding their pension plan in excess of minimum requirements and immediately claiming those amounts, and the contractor is protected by having the opportunity to recover those excess contributions in future years. However, it is important to note that the protection provided to the contractor by the prepayment credit feature is only as real as the timeliness of the cost recovery.

We believe prepayment credits should be retained in CAS, but again, this mechanism alone would not satisfy the requirement of harmonization.

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?

Several provisions of PPA may expose cost projections to volatility if adopted for CAS.

The comparably shorter amortization period (7 years) for unfunded liabilities under PPA will reduce the smoothing effects of current CAS (10-30 years). This shortened amortization period would result in increased cost amounts over a shorter period of time.

The short (2 year) rolling average used as the bond interest rate for discounting the future pension liability will expose the liability calculation to market volatility. Current CAS generally uses a single steady discount rate over a long period of time. Because the liability balances involved are significant, even minor market fluctuations may translate into large dollar impacts.

The narrower corridor (90% to 110%), as compared with the current corridor (80% to 120%), allows for less tolerance of asset valuations outside the market acceptable measure requiring adjustment to market. This is likely to result in more frequent asset adjustments to market value. Furthermore, the short (2 year) amortization period for these mark-to-market adjustments provides little smoothing of this volatility by comparison with the current 15 year amortization period in CAS used for actuarial gains and losses.

Despite these exposures to volatility, we believe that adoption of the calculations used by PPA in the revised CAS is generally necessary to satisfy the harmonization requirement. We do recognize, however, that such volatility may be undesirable to the Government, and we believe the Board has options to address the Government's concerns. We encourage the Board to adopt the provisions as recommended of PPA and consider options to mitigate the volatility as necessary.

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

We believe the Board has several options to address the volatility exposures from the adoption of PPA provisions for revised CAS to achieve harmonization.

One option for mitigating the volatility may be some sort of amortization feature that allows contractors to begin recovering costs immediately, but spreads the cost recovery evenly over an equitable period of time into the future. This concept is a similar approach to smoothing techniques in current CAS.

A second option for mitigating the volatility is establishing some sort of minimum and maximum cost recovery range. If cost calculations result in an amount outside the range, the difference would then be recognized in future years.

A third option, which is more unique to the immediate implementation of the harmonized CAS, is publication of transitional rules to smooth any abrupt spike in pension cost resulting from the revised CAS. We presume such rules would involve recognition of a short term spike in costs evenly over a stated period of years. We strongly urge the Board to consider transitional rules to protect both the Government and contractors.

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?

We recommend the assignable cost limitation concept be retained in CAS with revisions to the asset and liability measurements to correspond with those in PPA. We believe this provision would still be effective for underfunded pension plans and is acceptable within the context of our recommendation to generally align the calculations of both PPA and CAS.

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

We recommend CAS not be revised to allow for negative pension costs. In order for pension costs for CAS to be claimed, those costs must be funded by assets in the trust which cannot be withdrawn. If negative pension costs were permitted for CAS, contractors would be funding pensions costs twice, once through required contributions into the pension trust and then again to the Government.

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

We recommend that the PPA funding target calculation should be the basis of measurement for the segment closing adjustment calculation in the revised CAS. This would again generally align the calculations of both PPA and CAS.

We also recommend that the Board retain the CAS concepts for the settling up of any underfunding (unfunded liability) or overfunding (less prepayment credits) related to previously claimed CAS pension costs, the provisions for segment closings due to transfers of ownership, and the provisions for plan terminations in which the liability is measured by the amount paid to irrevocably settle the benefit obligations. We believe these additional provisions address specific situations found in Government contracting that are beyond the scope of PPA and the requirement of harmonization.

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?

The curtailment provisions in current CAS anticipate the permanent cessation of material benefit accruals for a pension plan. However, this is not an accurate description of "at risk" plans as defined by the PPA. In fact, after sufficient funding contributions are made, the benefit accruals not only resume, but catch up as if the cessation had not occurred. We believe that should the curtailment provision be retained in CAS during harmonization, PPA defined "at risk" plans should be excluded as curtailments.

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 assets" for the period?

We recommend that the actual return on assets be used for prepayment credits. While credit balances for PPA are not the same as prepayment credits for CAS, they are both part of the total assets which collectively for PPA will be adjusted for actual return on assets. Thus, we believe total assets for CAS, including prepayment credits, should be adjusted for actual return on assets in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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?

We recommend that interest adjustments for contributions be based on the actual deposit dates as required by PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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

We recommend using the same criteria as those used by PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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

We recommend using the same criteria as those used by PPA. This is in accordance with our recommendation that the Board achieve harmonization by essentially basing the calculations for CAS on those of PPA.

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.

We appreciate that the Board understands the importance of reviewing data to evaluate the impacts of PPA and revisions to CAS. The impacts are likely to be different depending upon the circumstances of individual contractors, so we are hopeful that a number of information sources will be identified representing the diverse circumstances that exist across industry. Circumstances we encourage the Board to consider while reviewing data include different funding levels (over, under), existing assignable cost deficits, existing prepayment credits, and those with “at risk” plans. At this early point in the process, general studies such as those from actuarial consulting firms may be of most use to the Board. As the Board establishes the direction it intends to take, data modeling results will be a valuable tool industry can provide.

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 to support the contractor’s proposed and/or claimed pension cost?

FAR already includes requirements for supporting documentation for costs proposed and/or claimed, so no change in CAS is necessary.

Thank you for this chance to support the Board in this important undertaking. We look forward to additional opportunities in the future.