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August 30, 2007

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

Re: CAS–2007–02S

Dear Ms. Auletta:

This letter is a response to the Staff Discussion Paper (SDP) regarding the Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006 (PPA).

We are writing on behalf of The Segal Company, a national actuarial and employee benefits consulting firm, and, its Sibson Consulting division. Segal has had extensive experience with determining pension costs under the Cost Accounting Standards (CAS) on behalf of its government contractor clients. Briefly stated, we believe that Standards 412 and 413 should incorporate the key principles of the PPA.

The PPA Changes

The PPA completely rewrote the funding rules for single-employer defined benefit pension plans. The changes include:

- ***Creation of a New "Funding Target" that Requires 100 Percent Funding over Seven Years*** Instead of "actuarial accrued liability, the new rules focus on a "funding target." The PPA requires single employer plans to amortize their funding target— whether due to plan amendments, assumption changes or experience losses — over seven years.

- ***Single Funding Method*** For minimum funding purposes, employers will no longer be able to choose a funding method to match to their preferred cash-flow budgets. The funding target will be based on benefits accrued as of the beginning of the plan year; and all benefit growth during the year, including increases in previously earned benefits due to pay raises, will be included in each year's "target normal cost."

- ***Prescribed Actuarial Assumptions*** The PPA requires all plans to use an interest rate based on a Treasury-devised index of rates on investment-grade corporate bonds. These rates will be reflected in a simplified yield curve that will take into account each plan's demographics. The PPA also mandates use of a specific mortality table, with some exceptions.

- ***Limited "Smoothing" of Measurements*** Asset values can be smoothed over no more than 24 months and will have to be within 90 to 110 percent of market value. Interest rates will also have to be averaged over 24 months (down from the four-year average used for the Deficit Reduction Contribution and the long-term assumptions otherwise used).

Thus, the PPA changed the minimum funding requirements to utilize a mark-to-market approach that looks to the current financial markets to determine the value of the assets and liabilities of the pension plan.

CAS Harmonization: Updating CAS 412 and 413

The PPA requires the Cost Accounting Standards Board to revise CAS 412 and 413 to "harmonize" government reimbursable pension plan costs with the minimum required contribution.

In addition, CAS costs should follow the minimum required contribution rules in order to maintain fairness and equity. The original Standards 412 and 413 were modeled after the minimum funding requirements of ERISA. However, over the ensuing years, minimum funding and CAS rules have diverged. In many cases, an additional deficit reduction contribution was required, but there was no corresponding CAS allowable cost. In many cases, government contractors have had to make contributions that have not been reimbursable over many years and have built up large prepayment credits that may not usable for many years in the future. Without harmonization, the PPA changes would exacerbate the problem of CAS costs not matching the contribution requirements.

While some disagree with the mark-to-market philosophy, this approach has been required by the accounting profession for quite a while. Under rules issued by the Financial Accounting Standards Board and the International Accounting Standards Board, discount rates must reflect the current financial markets and smoothing of costs is limited. Now, that the PPA has adopted this approach for funding, CAS 412 and 413 should follow this approach.

Thus, Standards 412 and 413 should incorporate the key principles of the PPA.

CAS Harmonization: Mitigating Volatility

The SDP requested comments on mitigating volatility because several provisions of the PPA, such as utilizing a market-based yield curve, may make it harder to predict and manage costs. While this is of real concern — for all pension sponsors and not just for the federal government, which assumes risk under cost-plus contracts, and for government contractors, which assume risk

under fixed-price contracts. Still, the PPA clearly requires that CAS costs be harmonized with the minimum required contribution. The effect of volatility can be minimized by amortizing extraordinary gains or losses.

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We are aware that several groups have already submitted comments with additional details. So as not to be repetitive in our comments, we point out that Segal is a member of the National Defense Industrial Association, and we concur in broad measure with its comments, as well as with those submitted by Messrs. Curtis, Friedman, Ma, McQuade, Rich and Tully, both of which are attached.

We appreciate the opportunity to comment and look forward to participating in future discussions.

Sincerely,

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Attachments