August 9, 2007

Cost Accounting Standards Board, ATTN: Laura Auletta
Office of Federal Procurement Policy
725 17th Street, NW
Room 9013
Washington, DC 20503

Re: CAS-2007-02S

This letter represents our response to the Staff Discussion Paper issued on July 3, 2007 by the Cost Accounting Standards Board pertaining to the harmonization of CAS 412 and 413 with the Pension Protection Act of 2006.

Background and Fundamental Principles

All of the Cost Accounting Standards reflect the intent to maintain:

(1) equity between the government and its contractors,

(2) uniformity among the contractors in how reimbursable expenses are developed and when they are charged to the government, and

(3) a timely match between when the charges attributable to a contract are incurred and when they become recoverable.

When the two standards that address pension costs, CAS 412 and 413, were first developed in the 1970s and then later revised in 1995, the authors did their best to reflect the intent described above. However, over the last twenty years, the financial community, including regulators, investors and accountants, have come to view pensions very differently than they had in the 1970s, when ERISA and CAS 412 and 413 were first promulgated. In particular, most regulators and legislators, both in the United States and abroad, have come to view pension obligations and assets as market-driven entities that are preferably measured on an immediate, marked-to-market basis. This view differs greatly from the view held 30 years ago, when the long-term nature of the obligation made a “smoothed” view of assets and obligations appear preferable.

This change in view is attributable, at least in part, to the relatively recent history of pension defaults, which demonstrated that a smoothed approach works only if the plan sponsor remains viable during the most severe downturns. Other factors that may have contributed to the prevailing market-based view include the fact that the pension assets and liabilities have grown significantly over the decades, both in absolute dollars and as a proportion of the sponsoring companies' underlying business base, and a general shift toward market-based assessments of many types of intangible, non-fungible assets and liabilities.

One result of this change in approach is the passage of the Pension Protection Act (PPA) and its requirement that CAS 412 and 413 be "harmonized" with the "minimum required contributions" determined in accordance with PPA. This requirement implies that the actuarial approach used to determine pension costs under government contracts will become less smoothed and more market-based, which will almost inevitably result in a more volatile pattern of pension expense.

Even if the expense does become more volatile, the fundamental principles still apply. Equity still needs to be preserved: if the government reimburses a contractor for a pension cost, there should never be an opportunity to charge the government again for that cost. Conversely, if the contractor incurs a pension cost and meets the criteria for reimbursement, then the cost should be reimbursed. And if the contractor contributes to a pension plan an amount in excess of the reimbursable cost, then the excess amount remains attributable to the contractor as a prepayment credit until such time as the contractor is reimbursed in future years.

The "harmonization" requirement needs to be addressed within the context of the changed attitudes regarding pension liabilities and the resulting expense while still maintaining the integrity of the three CAS principles cited above.

Harmonization of CAS 412 and 413 with PPA

As noted in the Staff Discussion Paper, "Section 106 of the PPA instructs the Board to harmonize the CAS with the minimum required contribution ..." Before addressing the specific questions posed in the Staff Discussion Paper, it is useful to first comment upon the overall goal of "harmonization."

We begin by reviewing the meaning of the term "harmonization." Merriam-Webster's Online Dictionary defines "harmonize" as "to bring into consonance or accord." Black's Law Dictionary, Eighth Edition, offers the following definition:

> **harmony.** Agreement or accord; conformity <the decision in *Jones* is in harmony with earlier Supreme Court precedent>. – **harmonize,** *vb*.

Based on the preceding, we view the goal of "harmonization" to be this: pension cost under CAS 412 should generally "conform" to the definition and calculation of the PPA minimum required contribution. Given the inherent differences between government

contract accounting and minimum funding, however, some differences are inevitable, as discussed below. Nonetheless, our comments are generally predicated on the notion that CAS 412 and 413 should be modified to bring the two Standards as close to PPA as is feasible.

With that background, we now address each of the questions posed in the Staff Discussion Paper. Our responses follow a common theme and hence are interdependent; as such, the responses to individual questions should not be considered in isolation.

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 Board should apply any revisions to all contractors for the following reasons:

a. Conceptually, it would make no sense to have two different sets of pension accounting rules apply to contractors based on size. Such a program would be confusing to contractors and government personnel alike.

b. Two sets of rules could lead to unintentional negative consequences for the contracting parties. For example, consider a competition between a small and large contractor competing for the same contract; if each was subject to different versions of CAS 412 and 413, the resulting differences in pension costs could skew the result of the competition.

c. One set of pension rules would better meet the Board's stated goal of achieving uniform accounting practices among contractors.

d. Contractors who barely meet or barely miss the sales and/or business thresholds under Section 106 of PPA could move in and out of "eligible government contractor" status due to periodic swings in their government contracting business activities; in such cases it would be difficult or impossible to monitor compliance. Likewise, acquisitions or divestitures could result in changes in status as an "eligible government contractor" as the test is formulaic in nature.

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?

At the outset, even a cursory review of the fundamental differences between the current CAS and new PPA rules reveals that important and fundamental differences are present between the two sets of rules. In addition, we believe that Congress has expressed its intent to "protect retirement security, to strengthen funding and ensure PBGC solvency" through the provisions of PPA generally; Section 106 of PPA appears unrelated to these matters. Rather, the purpose of Section 106 seems quite clear – it is to provide equity

to government contractors by ensuring they are not required to make cash contributions that far exceed the amounts of pension costs that can be allocated to their government contracts.

That said, we infer that the real question being posed here is this: are the current CAS 412 and 413 already "harmonized" with PPA so that revisions to the Standards are not needed? If that is indeed the question, the answer is "no," they are not currently in harmony. We note that the statue explicitly states Congress' intent that revisions to CAS 412 and 413 are indeed required to effect "harmonization." As the Staff Discussion Paper notes:

> In Section 106, Congress instructs the Board to:
>
> > " * * * review <u>and revise</u> sections 412 and 413 of the Cost Accounting Standards * * * to harmonize the minimum required contribution * * * of eligible government contractor plans and government reimbursable pension plan costs not later than January 1, 2010." [emphasis added]

If Congress believed there was a chance that the present CAS were in harmony with PPA, it presumably would not have directed the Board to make revisions, but rather would have instructed the Board to determine if any revisions were necessary.

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?

CAS harmonization should be focused on determining the annual cost under CAS 412 and 413 in a manner that meets both the letter and the spirit of Section 106 of PPA. The Board that promulgated the original version of CAS 412 in 1975 drew heavily on the minimum funding provisions of ERISA, thereby ensuring that contractors could generally recover the full amount of their pension contributions. That same principle – where contractors that fund their pension plans at the minimum required contribution level should neither gain nor lose from a cash flow perspective – should result from a harmonized version of CAS 412 and 413.

(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?

We are not clear exactly what the Board is asking in this question. Certainly, the current version of CAS 412 and 413 can result in substantial cash flow problems for contractors, because minimum funding requirements frequently exceed pension costs determined under CAS 412 and 413, and this condition would be exacerbated under PPA in the absence of CAS harmonization. Whether this would be considered a "penalty under ERISA" is not clear, however. Current CAS 412 and 413 do not require funding in excess of maximum deductible limits, thereby protecting contractors against

the imposition of excise taxes. We believe that similar provisions should be incorporated into the harmonized CAS 412 and 413.

(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?

We first note that Section 106 of PPA mandates CAS Board harmonization with only the minimum contribution; accordingly, a focus on the maximum deductible amount seems unwarranted. From a practical perspective, if the Board concurs with the recommendations presented in this letter, we believe that it would be unnecessary to include a range other than that included in the present CAS 412 and 413 (i.e., that CAS pension costs can neither be less than zero nor more than the sum of the maximum deductible amount and prepayment credits). Assuming the Board retains the current requirement that CAS pension costs be funded, however, we recommend that the range cited in the prior sentence and the current "assignable cost credit" and "assignable cost deficit" methodology be retained.

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

In our view, ERISA credit balances, which represent cumulative funding in excess of ERISA minimum contributions, represent an aspect of PPA that should not be harmonized with CAS 412 and 413. Instead, CAS prepayment credits should be treated under CAS 412 and 413 in a manner similar in some ways to the treatment ERISA credit balances receive under PPA. For example, the present CAS 412 and 413 rule that requires prepayment credits to be applied to reduce assets, which is similar to the treatment required under ERISA, should be retained. To be clear, if the total assets for a plan were $1,000, and CAS prepayment credits were $100, the asset value used for CAS purposes would be $900.

At the same time, however, there are fundamental differences between ERISA credit balances and CAS prepayment credits. When ERISA was enacted, Congress intended pension plans to become adequately funded over a period of several years, and was less focused on the year-to-year variability in funded status. Accordingly, Congress provided plan sponsors with funding flexibility – by funding more than the minimum amount in one year, a credit balance would be created that would permit the sponsors to pay less than the minimum in another year.

The type of flexibility that was originally provided for ERISA minimum funding purposes – where contractors could exercise discretion over the amount of their contributions for a year – would be inappropriate for government contracting purposes (that is because this type of control would contradict the CAS Board's goal of "consistency" in cost accounting practices). In addition, prepayment credits represent amounts that a government contractor has contributed to a plan but has not yet allocated to government contracts as a pension cost.

For these reasons, prepayment credits should remain available to fund CAS pension costs but should not comprise an element of those costs. Stated differently, CAS pension costs should equal the sum of (1) normal costs (such as the "target normal cost" under PPA), plus (2) amortization payments (such as the "shortfall amortization charge" under PPA), plus (3) appropriate interest adjustments; prepayment credits should not be applied to reduce the amount of the measured and assigned CAS cost.

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

To meet Congress' goal of harmonization, as well as to minimize ongoing actuarial fees and the potential for disputes, we believe that the revised CAS should utilize the actuarial "building blocks" of PPA. For example, the PPA "funding target" should replace the current "actuarial accrued liability" and the "target normal cost" should be used in lieu of the present "normal cost."

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

As was the case with our response to question 3(a) above, it is not clear to us exactly what this question means. Because it is our understanding that the Board is revising CAS 412 and 413 solely to meet the "harmonization" requirements of Section 106 of PPA, it does not seem necessary for the Board to consider such a broad question at this juncture.

(ii) To what extent, if any, should the Board consider concerns with the solvency of either the pension plan, or the PBGC?

As was the case in the immediately preceding point, the question posed appears to be beyond the mandate of the Board. The requirements of PPA generally represent Congressional intent with respect to the solvency of pension plans as well as the PBGC. In our view, the Board need only be concerned with the requirements of Section 106 of PPA, which focuses on restoring balance between the PPA minimum contribution and pension costs under CAS 412 and 413.

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?

Before addressing this question, we first note that the Board seems to mischaracterize PPA. Specifically, the PPA approach to ongoing minimum funding is not a "liquidation or settlement" approach. Although PPA contains many requirements that differ from the historical approach to "going concern" accounting (as embodied in the present CAS 412 and 413), and although some aspects of minimum funding calculations under PPA bear similarities to liquidation/settlement methodology, PPA nonetheless contains many attributes of ongoing accounting.[1] We further note that the question as posed would suggest that the continuing evolution in "going concern" financial accounting would constitute a "liquidation or settlement" basis which, as a matter of logic, cannot be the case.[2]

With that background, PPA has redefined the meaning of "going concern" minimum funding requirements under ERISA. In our view, it would be absurd for the Board to be the only regulatory body requiring the use of "old" actuarial methodology. For example, actuarial software would be required to produce liabilities under methods that would apply for CAS purposes only; system maintenance and training for the relatively small base of contractors sponsoring defined benefit plans would be expensive and the chance for errors would be high. Audits would become more contentious, as government experts would share many of the same challenges that would face contractors' actuaries. Disputes would be inevitable because accepted industry norms (based on surveys conducted by actuarial firms) of "old style" actuarial assumptions would no longer exist, and the actuarial assumptions in question would be made for CAS purposes only. The resulting cost and frustration could well encourage contractors to exit the defined benefit system.

In summary, it is our view that the Board should adopt the new "going concern" paradigm defined by PPA in developing revisions to CAS 412 and 413. For better or for worse, the world (i.e., Congress, the FAS Board and international accounting bodies) has adopted a new concept of determining pension costs for a "going concern"; it would be ill-advised for the CAS Board to decline to do likewise.

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[1] For example, PPA requires amortization of plan amendments, gains and losses, etc.; under settlement accounting, all such factors are recognized immediately. Similarly, PPA permits asset smoothing; for settlement purposes, market values must be used.

[2] We recognize that many defined benefit practitioners believe that the recent changes in minimum funding and financial accounting requirements are ill-advised. Any such concerns, however, are irrelevant to the task at hand because the new approaches to minimum funding and financial accounting represent fundamental "givens" in today's business world.

(b) Actuarial Assumptions. 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, in adopting the PPA “building blocks” as described above, should simultaneously embrace the PPA actuarial assumptions. Specifically, the assumptions used by a contractor for ERISA purposes should be mandatory for CAS purposes. We note that this approach will ensure a far greater degree of uniformity than has existed under either of the prior versions of CAS 412 and 413.

(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?

As stated in our response to question 4(b), the PPA interest rates should also be used for CAS purposes.

(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?

Consistent with our response to question 4(b), the interest rate assumption would be set in accordance with PPA and there would be no need to consider the present investment policy and/or mix.

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

As stated in our response to question 4(b), the PPA assumptions should also be used for CAS purposes. Consistent with the PPA, salary increases would not be permitted other than the one-year projection required for the PPA “target normal cost“ as well as the determination of the maximum deductible contribution under PPA which, as discussed in our response to question 3(b), should continue to be utilized in determining the maximum amount of assignable CAS cost.

(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?

As stated in our response to question 4(b), the mortality table adopted for PPA purposes would also be used for CAS purposes. Thus, CAS 412 and 413 would not be required to deal with mortality assumptions, but rather would incorporate the minor degree of flexibility provided for by PPA.

(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?

It is difficult to understand how Congress direction to “harmonize” CAS 412 and 413 with PPA would be served by utilizing any amortization period other than the 7 year period contained in PPA; for this reason, we recommend that 7 year amortization be extended to CAS purposes. By eliminating discretion, this approach would also help the Board attain increased uniformity. (In addition, please note the additional amortization/smoothing proposal discussed in our response to question 7(a)(i) below).

(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)?

Yes. Consistent with the principles described above, we recommend that the total actuarial asset value for a plan (prior to adjustment for credit balances and prepayments) be identical for CAS and PPA purposes.

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

Yes. As stated in our response to question 5(e)(i), we recommend that the total actuarial asset value for a plan (prior to adjustment for credit balances and prepayments) be the same for CAS and PPA purposes.

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

In directing harmonization of CAS with PPA minimum funding requirements, Congress made no distinction between plans that are "at risk" versus those that are not. Accordingly, under the "building block" approach, no special requirements would be required for "at risk" plans under CAS (also see our comments on curtailments in our response to question 8(b)). As would be the case generally under our proposal, the "building blocks" used under PPA would also be used for CAS purposes, regardless of whether the plan is "at risk" or not.

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?

It is our understanding that the purpose of Section 106 of PPA was to provide cash flow relief to government contractors. Specifically, the goal of harmonization is to minimize the extent of negative cash flow that contractors would suffer due to PPA minimum funding requirements exceeding assignable costs under the current CAS 412 and 413.

Under our proposal, no special provisions would be required in CAS 412 and 413 to deal with contractor cash flow issues; instead, the recommended symmetry between PPA and CAS, coupled with the predictability provisions in our response to question 7(a)(i), should sufficiently resolve contractor cash flow concerns in a reasonable and equitable manner.

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

In concept, the current prepayment provisions mitigate cash flow concerns in that cash flow shortfalls are presumably 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."

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

Conceptually, no revisions to the current prepayment provisions would be needed under our proposal (notwithstanding, a technical point concerning interest on prepayment credits is discussed below in our response to question 9(a)).

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.

At the outset, it is important for the Board to distinguish between volatility and predictability, and to identify the precise problems that can result. Due to the marked-to-market nature of PPA, with the attendant reduction in smoothing versus the traditional ERISA or CAS rules, it is likely that more volatility will exist in the resulting calculations. However, as explained below, it is our experience that the primary problem in practice over the last few decades has concerned predictability and the consequent impact on negotiated fixed price contracts. Given the nature of PPA, and assuming that funding of pension costs will continue to be required under CAS, we believe that it will be difficult to address this issue through traditional means of smoothing pension costs. However, a new CAS accounting concept – essentially a "pension cost stabilization account" – might yield a result that could satisfy the interests of both parties. The concept is most easily illustrated through a numerical example.

Suppose a contractor forecasts that its CAS pension costs will annually fluctuate between $0 and $100. Such a result is clearly volatile. However, further suppose that the contractor is able to accurately forecast its pension costs so that the amount of actual pension costs allocated to negotiated fixed price contracts is always equal to the amount that was forecast through the forward pricing process. Although volatile, this hypothetical contractor's pension cost would be predictable. As such, the amount of pension costs actually allocated to all negotiated government contracts would be in line with expectations, and neither contracting party would gain any advantage due to the volatility. In practice, however, it is the unexpected differences between actual and forecasted pension costs that yield what either party might view to be a windfall or shortfall on fixed price contracts.

To address this, we propose a two-pronged approach to pension costs. The first would, consistent with historical practice, govern the measurement, assignment and allocation of pension costs. We acknowledge that our proposal to utilize PPA "building blocks" for the revised CAS 412 and 413 would likely result in pension costs that are more difficult to predict. Accordingly, the second aspect of our proposal – the "pension cost stabilization account" mentioned above – is designed solely to address the predictability problem. In general, we recommend that CAS 412 and 413 permit the parties to identify the difference between actual and forecasted pension costs for a year, and to amortize the portion of that difference associated with negotiated fixed price contracts over some reasonable period.

Again, an example helps to illustrate the concept. Suppose pension cost for a year is forecasted to be $100 but, due to favorable investment performance, is actually only $80. Consistent with long-established principles, the $80 in cost would be assigned to the period and, if funded, would be allocated to cost objectives. In addition, assume 50% of the $80 pension cost (i.e., $40) is allocated to negotiated fixed price contracts. Although it is impossible to determine the amount of pension costs actually embedded

in the price of a fixed price contract, assume that 50% of the $100 forecast (i.e., $50) was included in the fixed prices. Under this admittedly simplified view of fixed price contracts, the contractor would have recovered $10 more than expected (i.e., expected costs of $50 minus actual costs of $40). Because this differential does not represent an element of CAS pension cost, and has not been contributed to the pension fund, it would be available to be returned to the government through reductions in the price of future negotiated fixed price contracts as explained below. Note that our proposal applies equally if costs were higher than expected (i.e., if pension costs were actually $120 versus the $100 forecast, the contractor would be entitled to increased recovery of 50% of the $20 difference, or $10, again through future negotiated fixed price contracts as explained below).

Once the impact of unpredictable differences between actual and forecasted costs has been identified for fixed price contracts, we propose that the differences (which would be accumulated in a “pension cost stabilization account”) be amortized over a suitable period of years. For example, the $10 differential described in the preceding paragraph might be returned to the government (or recovered by the contractor, depending upon whether forecasted pension costs were too high or too low) through annual pension forecast credits equating to a $2 impact on the prices of negotiated fixed price contracts for each of the next 5 years. By amortizing these charges and credits over a period of years, the net amount of charge or credit will tend to be smooth, and favorable and unfavorable experience will tend to offset, thereby enhancing predictability of overall pension costs. This same type of approach could also be used to address the disposition of a business unit or other segment closing that might require an equitable distribution of any unliquidated “pension cost stabilization account” balances then remaining.

We recognize that this concept requires further investigation and modeling. We also note that the revised CAS 412 and 413 may require additional direction to enhance uniformity and consistency in pension cost forward pricing practices. Notwithstanding, this approach has the twin advantages of (1) permitting the Board to adopt a simplified version of CAS 412 and 413 that, by relying on the PPA “building blocks,” would be equitable as well as easy to administer and audit and (2) introducing a fair and auditable approach to correcting for the unexpected fluctuations in pension costs.

In addition to the predictability issue, at the time any revisions to the CAS become effective, there will obviously be some differences between cost that had been previously forecasted under the current CAS and the revised cost that reflects any changes to the CAS. These differences will comprise another element of previously unpredicted cost variation. This would suggest that there should be a mechanism similar to the smoothing concept outlined above to deal with this transitional situation.

(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?

Other than utilizing the PPA "building blocks," the assignable cost limitation does not require modification.

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

Under our proposal, and consistent with current CAS 412, CAS pension costs would be required to be funded; as such, those costs should not be permitted to be below zero (because, once funded, the contractor would be unable to make a refund under present pension law). Note that the second aspect of our proposed methodology as described in our response to question 7(a) above (i.e., the charge or credit resulting from variances between actual and forecasted pension costs) could be negative (i.e., could result in a credit to the government).

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)?

As is the case with our proposal generally, we believe that the PPA "building blocks" would apply. Consistent with this approach, the PPA "funding target" would be used as the segment closing liability under CAS 413.50(c)(12). We further note that any other result would be inconsistent with a harmonized version of CAS. Specifically, assume a contractor's experience always tracked its actuarial assumptions; this would result in assets at the time of segment closing that would equal the PPA "funding target." In such a case, it seems clear that the segment closing adjustment should be zero, because everything worked out exactly as expected. In the absence of a plan termination (in which case the cost of annuities and lump sum payments should be used as the measure of liabilities), the use of any measure of liability other than the PPA "funding target" at the time of a segment closing would make no sense.

In addition, please note our comments at the end of our response to Question 7(a),

(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?

Because a "curtailment" under current CAS 413 represents neither the termination of the pension plan nor the termination of the contracting relationship, we recommend that the one-time settling up now required in connection with a curtailment be eliminated. In this manner, annual CAS pension costs would continue to be measured, assigned and allocated for curtailed plans. At a minimum, the PPA mandatory cessation of benefit accruals for "at risk" plans should be exempted from "curtailment" accounting.

Question 9. (a) Prepayment Credits. 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?

Consistent with our general recommendations, we believe that the PPA "actual return" methodology should apply to prepayment credits subsequent to the effective date of the revised CAS. This approach will be less susceptible to error and would result in greater harmony between CAS and PPA.

(b) Contributions Made After End of Plan Year. 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?

Consistent with our general recommendations, we believe that interest adjustments on CAS pension costs should be computed based on the actual deposit dates. This approach will be less susceptible to error and will facilitate audits by ensuring symmetry between PPA and CAS amortization amounts. This will also resolve the present inconsistency between the views of CMS (which presumes that contributions made after the end of a plan year be treated as if made on the last day of the year) and DCAA (which determines the difference between actual funding dates and FAR scheduled dates, even if after the end of the year; see DCAA Contract Audit Manual 7.605.2d.(2)).

(c) Collectively Bargained Benefits. (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?

We urge the Board to adopt the treatment accorded under PPA.

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

We urge the Board to adopt the treatment accorded under 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 agree that this analysis should be an important aspect of developing revisions to CAS 412 and 413. To accomplish this goal, we recommend that the Board tentatively resolve the major issues affecting harmonization in its deliberations prior to publishing an advanced notice of proposed rulemaking. By narrowing the range of possibilities, it will be much easier for industry to model the consequences associated with proposed revisions and thereby provide the Board with actionable information. Although we understand the need for a rapid promulgation process in order to meet the effective

dates imposed by Section 106 of PPA, sufficient time will be needed to complete a robust modeling effort. For this reason, once the Board publishes its initial thoughts on harmonization, we recommend an extended comment period (i.e., at least 120 days) to allow industry sufficient time to digest the proposed approach, undertake modeling, analyze the results of the modeling, and provide suitable feedback to the Board.

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?

We are not clear what information the Board is seeking here. In particular, we are not sure what additional recordkeeping requirements might be prompted by CAS harmonization.

* * *

We appreciate the opportunity to comment on the Staff Discussion Paper. Although we have listed our organizational affiliations and contact information, please note that we are making our response as individuals. As such, this response does not necessarily represent the views of our employers.

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