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Rec'd 11/03/2008 5:10 PM

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

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

NOV - 3 2008

SUBJECT: Cost Accounting Standard (CAS) Pension Harmonization Advance Notice of Proposed Rulemaking (ANPRM)

Dear Sir:

We reviewed the Cost Accounting Standards (CAS) Board's Advance Notice of Proposed Rulemaking (ANPRM) on harmonizing CAS 412 and 413 with the Pension Protection Act (PPA) of 2006. We identified issues related to the accumulated value of prepayment credits and have comments on two of the changes discussed in the "Summary Description of Draft Proposed Standard" section of the ANPRM.

First, on item 2, "Mandatory Prepayment Credits," the actual net rate of return on investments should be used to adjust the value of and the accumulated value of mandatory prepayment credits. The ANPRM states, "Because neither the mandatory nor voluntary prepayment credits have been allocated to segments or cost objectives, these prepayments continue to be unallocated assets and will be excluded from the asset value used to measure the pension cost." Although prepayment credits are unallocated assets, the ANPRM language overlooks the fact that the current use of the long-term interest assumption rate to value prepayment credits has historically impacted the measurement of pension cost. Because the gains and losses attributable to prepayment credits do not accrue against the prepayment credits, they are credited or charged against the assets, thereby leveraging the impact of the gain or loss on the measurement of pension costs. Therefore, for prepayment credits to have no impact on the measurement of pension costs, they must be valued at the actual net rate of return on investments.

Second, item 8, "Interest on Voluntary Prepayments and Unfunded Pension Costs," should also include recognition of extraordinary events. The ANPRM states,

> Funding less than the assigned cost or funding in excess of the assigned pension cost is a financial management decision made by the contractor. Measurement and assignment for contract costing purposes should be

independent of that unilateral decision. Therefore, the draft rule being proposed adjusts the value of and the accumulated value of voluntary prepayment credits at the actual net rate of return on investments rather than the long-term interest assumption. This accounting treatment is consistent with the adjustment of carry-over and prefunding balances under the PPA.

We agree with the proposed change to use the actual net rate of return on investments to adjust the value of and the accumulated value of voluntary prepayment credits. However, we are concerned with the implementation of the proposed change. Many Government contractor pension plans have been around for a long time and have accumulated large surpluses. We have seen an influx of significant prepayment credits by Government contractors in recent years. The current historic adjustment in the stock market is an extraordinary event. Implementation of the new rule could create a situation where huge market adjustments attributable to the prepayment credits will be leveraged against the Government share of contractor pension assets while the prepayment credits are left, not only untouched, but increased by the long-term interest assumption rate. After implementation of the proposed change, the prepayment credits will then share in future market rebounds. Therefore, consideration should be given to the impact of the asset loss from this extraordinary event in the implementation of the proposed ruling. Additionally, special recognition of extraordinary events should be included in the basic rule for annual costing and segment closings.

Thank you for the opportunity to comment on the proposed rule. If you have any questions, please contact Ms. Mary McBarron, Auditor, Department of Defense, Office of the Inspector General, 400 Army Navy Drive, Arlington, VA, 22202-4704, at (216) 706-0074, or by e-mail at Mary.McBarron@dodig.mil.

Sincerely,

Carolyn R. Davis

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Assistant Inspector General
for Audit Policy and Oversight