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**Department of Defense
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48 CFR Parts 31 and 52

**Federal Acquisition Regulation; Insurance
and Pension Costs; Proposed Rule**

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Parts 31 and 52**

[FAR Case 2001–037]

RIN 9000–AJ57

**Federal Acquisition Regulation;
Insurance and Pension Costs**

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Proposed rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the Federal Acquisition Regulation (FAR) to amend the insurance and indemnification cost principle and the portion of the compensation cost principle relating to pension costs.

DATES: Interested parties should submit comments in writing on or before March 31, 2003 to be considered in the formulation of a final rule.

ADDRESSES: Submit written comments to—General Services Administration, FAR Secretariat (MVA), 1800 F Street, NW., Room 4035, Attn: Laurie Duarte, Washington, DC 20405.

Submit electronic comments via the Internet to—farcase.2001-037@gsa.gov.

Please submit comments only and cite FAR case 2001–037 in all correspondence related to this case.

FOR FURTHER INFORMATION CONTACT: The FAR Secretariat, Room 4035, GS Building, Washington, DC 20405, at (202) 501–4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Ralph De Stefano at (202) 501–1758. Please cite FAR case 2001–037.

SUPPLEMENTARY INFORMATION:**A. Background**

The Councils have performed an analysis of FAR 31.205–6(j), Pension costs, and FAR 31.205–19, Insurance and indemnification, and propose the following revisions:

1. Substitute the term “assign” for the term “account” in the newly renumbered paragraphs (j)(1) and (j)(5) of FAR 31.205–6 in order to be consistent with the terminology used in 48 CFR 9904.412, Cost Accounting

Standard for Composition and Measurement of Pension Cost (CAS 412), and 48 CFR 9904.413, Adjustment and Allocation of Pension Cost (CAS 413).

2. Revise the current paragraph (j)(4)(i) (renumbered as (j)(3)(i)) at FAR 31.205–6 and the contract clause at FAR 52.215–15 to specifically address how the Government will receive the pension cost adjustment amount when there is a segment closing, a pension plan termination, or a curtailment of benefits for CAS-covered and non-CAS-covered contracts.

3. Move and revise the current paragraph FAR 31.205–6(j)(8) that addresses employee stock ownership plans (ESOPs).

a. Move the discussion of ESOPs out of the current paragraph FAR 31.205–6(j) that addresses pension plans to a new paragraph FAR 31.205–6(q) so that the discussion of ESOPs is included in the coverage addressing all deferred compensation plans, both pension and nonpension.

b. Delete the term “individual” from the phrase “individual stock bonus plan” to preclude misinterpretation that a separate plan is required for each employee.

c. Add the term “primarily” to the phrase “invest in the stock of the employer corporation” to clarify that an ESOP does not have to invest 100 percent in the stock of the employer corporation.

d. Consistent with current policies and recent developments in applicable case law, clarify that ESOP costs are to be measured, assigned and allocated in accordance with 48 CFR 9904.412 for ESOPs that meet the definition of a pension plan, and in accordance with 48 CFR 9904.415, Accounting for the Cost of Deferred Compensation, for all other ESOPs. As ESOP accounting techniques continue to evolve, this FAR provision may require further modifications, *e.g.*, if the present CAS treatment of this topic is changed as a result of the current ESOP project being pursued by the CAS Board.

e. Increase the limitation of ESOP contributions in any one year from 15 percent to 25 percent, which is consistent with the Internal Revenue Code limitation on ESOP contributions for corporations.

f. Remove the requirement for the contracting officer to approve the contribution rate in order to be consistent with the requirements for defined contribution pension and deferred compensation plans that are not ESOPs.

4. Eliminate the discount rate provision at the current paragraph FAR

31.205–19(a)(3)(i). The CAS Board revised 48 CFR 9904.416, Accounting for Insurance Costs, to use the Treasury Rate, which is the same rate currently contained in the insurance and indemnification cost principle. Therefore, it is no longer necessary for the cost principle to specify the discount rate.

5. Other editorial changes. The rule makes other editorial changes, including deleting—

a. The current paragraph FAR 31.205–6(j)(1) since FAR 31.001 already has a definition of “pension plan” that is the same as the definition in CAS 412 and 413;

b. The descriptions of defined-benefit pension plans at FAR 31.205–6(j)(3) and defined-contribution pension plans at FAR 31.205–6(j)(5) since the definitions of these terms are currently at FAR 31.001.

c. References to “reasonableness” and “allocability” currently found at FAR 31.205–6(j)(2)(ii) and (j)(3)(ii) because these general allowability standards are already addressed at FAR 31.201–2 and FAR 31.201–3. The Councils do not intend to make these changes to alter any current policy.

This is not a significant regulatory action and, therefore, was not subject to review under section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

B. Regulatory Flexibility Act

The Councils do not expect this proposed rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because most contracts awarded to small entities use simplified acquisition procedures or are awarded on a competitive, fixed-price basis, and do not require application of the cost principles that are discussed in this rule. An Initial Regulatory Flexibility Analysis has, therefore, not been performed. We invite comments from small businesses and other interested parties. The Councils will consider comments from small entities concerning the affected FAR parts in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 601, *et seq.* (FAR case 2001–037), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the

approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

List of Subjects in 48 CFR Parts 31 and 52

Government procurement.

Dated: January 23, 2003.

Al Matera,

Director, Acquisition Policy Division.

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 31 and 52 as set forth below:

1. The authority citation for 48 CFR parts 31 and 52 continues to read as follows:

Authority: 40 U.S.C. 486(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 31—CONTRACT COST PRINCIPLES AND PROCEDURES

2. Amend section 31.205–6 by—
- Removing from the second sentence of paragraph (g)(1) “(j)(7)” and adding “(j)(6)” in its place;
 - Revising paragraph (j);
 - Removing from the second parenthetical in paragraph (p)(2)(i) “paragraphs (j)(5) and (j)(8)” and adding “paragraphs (j)(4) and (q)” in its place; and
 - Adding paragraph (q) to read as follows:

31.205–6 Compensation for personal services.

* * * * *

(j) *Pension costs.* (1) Pension plans are normally segregated into two types of plans: defined-benefit and defined-contribution pension plans. The contractor shall measure, assign, and allocate the costs of all defined-benefit pension plans and the costs of all defined-contribution pension plans in compliance with 48 CFR 9904.412—Cost Accounting Standard for Composition and Measurement of Pension Cost, and 48 CFR 9904.413—Adjustment and Allocation of Pension Cost. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in paragraph (j)(1)(i) and in paragraphs (j)(2) through (j)(6) of this section.

(i) Except for nonqualified pension plans using the pay-as-you-go cost method, to be allowable in the current year, the contractor shall fund pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year. For nonqualified pension plans using the pay-as-you-go method, to be allowable in the current year, the contractor shall allocate

pension costs in the cost accounting period that the pension costs are assigned.

(ii) Pension payments must be paid pursuant to an agreement entered into in good faith between the contractor and employees before the work or services are performed; and the terms and conditions of the established plan. The cost of changes in pension plans are not allowable if the changes are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future.

(iii) Except as provided for early retirement benefits in paragraph (j)(6) of this subsection, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs, unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the option of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of-living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(2) *Defined-benefit pension plans.* The cost limitations and exclusions pertaining to defined-benefit plans are as follows:

(i)(A) Except for nonqualified pension plans, pension costs (see 48 CFR 9904.412–40(a)(1)) assigned to the current accounting period, but not funded during it, are not allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any portion of pension cost computed for a cost accounting period, that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412–50(c)(5)).

(B) For nonqualified pension plans, except those using the pay-as-you-go cost method, allowable costs are limited to the amount allocable in accordance with 48 CFR 9904.412–50(d)(2).

(C) For nonqualified pension plans using the pay-as-you-go cost method, allowable costs are limited to the amounts allocable in accordance with 48 CFR 9904.412–50(d)(3).

(ii) Any amount funded in excess of the pension cost assigned to a cost accounting period is not allowable in that period and shall be accounted for as set forth at 48 CFR 9904.412–50(a)(4).

The excess amount is allowable in the future period to which it is assigned, to the extent it is not otherwise unallowable.

(iii) Increased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in 48 CFR 9904.413–50(c). The contractor shall make determinations of unallowable costs in accordance with the actuarial method used in calculating pension costs.

(iv) The contracting officer will consider the allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGCC) under ERISA section 4062 or 4064 arising from terminating an employee deferred compensation plan on a case-by-case basis, provided that if insurance was required by the PBGC under ERISA section 4023, it was so obtained and the indemnification payment is not recoverable under the insurance. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205–19(c)(3) and (d)(3), in the indemnification payment to the extent of its fair share.

(v) Increased pension costs resulting from the withdrawal of assets from a pension fund and transfer to another employee benefit plan fund, or transfer of assets to another account within the same fund, are unallowable except to the extent authorized by an advance agreement. If the withdrawal of assets from a pension fund is a plan termination under ERISA, the provisions of paragraph (j)(3) of this subsection apply. The advance agreement shall—

(A) State the amount of the Government's equitable share in the gross amount withdrawn or transferred; and

(B) Provide that the Government receive a credit equal to the amount of the Government's equitable share of the gross withdrawal or transfer.

(3) *Pension adjustments and asset reversions.* (i) For segment closings, pension plan terminations, or

curtailment of benefits, the amount of the adjustment shall be—

(A) For contracts and subcontracts that are subject to full coverage under the Cost Accounting Standards (CAS) Board rules and regulations, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413–50(c)(12);

(B) For contracts and subcontracts that are not subject to full coverage under the CAS, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413–50(c)(12), except the numerator of the fraction at 48 CFR 9904.413–50(c)(12)(vi) is the sum of the pension plan costs allocated to all non-CAS-covered contracts and subcontracts that are subject to Subpart 31.2 or for which cost or pricing data were submitted; and

(C) Credited to the Government either as a cost reduction or by cash refund, at the option of the Government.

(ii) For all other situations where assets revert to the contractor, or such assets are constructively received by it for any reason, the contractor shall, at the Government's option, make a refund or give a credit to the Government for its equitable share of the gross amount withdrawn. The Government's equitable share shall reflect the Government's participation in pension costs through those contracts for which cost or pricing data were submitted or that are subject to Subpart 31.2. Excise taxes on pension plan asset reversions or withdrawals under this paragraph (j)(3)(ii) are unallowable in accordance with 31.205–41(b)(6).

(4) *Defined-Contribution Pension Plans.* In addition to defined-contribution pension plans, this paragraph also covers profit sharing, savings plans, and other such plans, provided the plans fall within the definition of a pension plan at 31.001.

(i) Allowable pension cost is limited to the net contribution required to be made for a cost accounting period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA will be allowable in those future accounting periods in which the funding of such excess amounts occurs (see 48 CFR 9904.412–50(c)(5)).

(ii) The provisions of paragraphs (j)(2)(ii) and (iv) of this subsection apply to defined-contribution plans.

(5) *Pension plans using the pay-as-you-go cost method.* When using the pay-as-you-go cost method, the contractor shall measure, assign, and allocate the cost of pension plans in

accordance with 48 CFR 9904.412 and 9904.413. Pension costs for a pension plan using the pay-as-you-go cost method are allowable to the extent they are not otherwise unallowable.

(6) *Early Retirement Incentives.* An early retirement incentive is an incentive given to an employee to retire early. For contract costing purposes, costs of early retirement incentives are allowable subject to the pension cost criteria contained in paragraphs (j)(2)(i) through (iv) of this section provided—

(i) The contractor measures, assigns, and allocates the costs in accordance with the contractor's accounting practices for pension costs;

(ii) The incentives are in accordance with the terms and conditions of an early retirement incentive plan;

(iii) The contractor applies the plan only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The present value of the total incentives given to any employee in excess of the amount of the employee's annual salary for the previous fiscal year before the employee's retirement is unallowable. The contractor shall compute the present value in accordance with its accounting practices for pension costs. The contractor shall account for any unallowable costs in accordance with 48 CFR 9904.412–50(a)(2).

* * * * *

(q) *Employee stock ownership plans (ESOP).* (1) An ESOP is a stock bonus plan designed to invest primarily in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESOT) may be in the form of cash, stock, or property.

(2) Costs of ESOPs are allowable subject to the following conditions:

(i) For ESOPs that meet the definition of a pension plan at 31.001, the contractor—

(A) Measures, assigns, and allocates the costs in accordance with 48 CFR 9904.412;

(B) Funds the pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year; and

(C) Meets the requirements of paragraph (j)(2)(ii) of this section.

(ii) For ESOPs that do not meet the definition of a pension plan at 31.001, the contractor measures, assigns, and allocates costs in accordance with 48 CFR 9904.415.

(iii) Contributions by the contractor in any one year that exceed 25 percent of salaries and wages of employees participating in the plan in that year are unallowable.

(iv) When the contribution is in the form of stock, the value of the stock contribution is limited to the fair market value of the stock on the date that title is effectively transferred to the trust.

(v) When the contribution is in the form of cash—

(A) Stock purchases by the ESOT in excess of fair market value are unallowable; and

(B) When stock purchases are in excess of fair market value, the contractor shall credit the amount of the excess to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the contractor shall credit the excess price over fair market value to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan.

(vi) When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

* * * * *

3. Revise section 31.205–19 to read as follows:

31.205–19 Insurance and indemnification.

(a) Insurance by purchase or by self-insuring includes—

(1) Coverage the contractor is required to carry or to have approved, under the terms of the contract; and

(2) Any other coverage the contractor maintains in connection with the general conduct of its business.

(b) For purposes of applying the provisions of this subsection, the Government considers insurance provided by captive insurers (insurers owned by or under control of the contractor) as self-insurance, and charges for it shall comply with the provisions applicable to self-insurance costs in this subsection. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the Government will consider the insurance as purchased insurance.

(c) Whether or not the contract is subject to CAS, self-insurance charges

are allowable subject to paragraph (e) of this subsection and the following limitations:

(1) The contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416, Accounting for Insurance Costs.

(2) The contractor shall comply with FAR Part 28. However, approval of a contractor's insurance program in accordance with FAR Part 28 does not constitute a determination as to the allowability of the program's cost.

(3) If purchased insurance is available, any self-insurance charge plus insurance administration expenses in excess of the cost of comparable purchased insurance plus associated insurance administration expenses is unallowable.

(4) Self-insurance charges for risks of catastrophic losses (large dollar coverage with a very low frequency of loss) are unallowable (*see* 48 CFR 28.308(e)).

(d) Purchased insurance costs are allowable, subject to paragraph (e) of this subsection and the following limitations:

(1) For contracts subject to full CAS coverage, the contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416.

(2) For all contracts, premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) are unallowable to the extent they exceed the sum of—

(i) The amount that would have been allowed had the contractor insured directly with the captive insurer; and

(ii) Reasonable fronting company charges for services rendered.

(3) Actual losses are unallowable unless expressly provided for in the contract, except—

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable; and

(ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of business and that are not covered by insurance are allowable.

(e) Self-insurance and purchased insurance costs are subject to the cost limitations in the following paragraphs:

(1) Costs of insurance required or approved pursuant to the contract are allowable.

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable subject to the following limitations:

(i) Types and extent of coverage shall follow sound business practice, and the rates and premiums shall be reasonable.

(ii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of profit.

(iii) The cost of property insurance premiums for insurance coverage in excess of the acquisition cost of the insured assets is allowable only when the contractor has a formal written policy assuring that in the event the insured property is involuntarily converted, the new asset shall be valued at the book value of the replaced asset plus or minus adjustments for differences between insurance proceeds and actual replacement cost. If the contractor does not have such a formal written policy, the cost of premiums for insurance coverage in excess of the acquisition cost of the insured asset is unallowable.

(iv) Costs of insurance for the risk of loss of, or damage to, Government property are allowable only to the extent that the contractor is liable for such loss or damage and such insurance does not cover loss or damage which results from willful misconduct or lack of good faith on the part of any of the contractor's directors or officers, or other equivalent representatives.

(v) Costs of insurance on the lives of officers, partners, proprietors, or employees are allowable only to the extent that the insurance represents additional compensation (*see* 31.205-6).

(3) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials and workmanship is unallowable. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense.

(4) Premiums for retroactive or backdated insurance written to cover losses that have occurred and are known are unallowable.

(5) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (d)(3) of this subsection.

(6) Late premium payment charges related to employee deferred compensation plan insurance incurred pursuant to Section 4007 (29 U.S.C. 1307) or Section 4023 (29 U.S.C. 1323) of the Employee Retirement Income Security Act of 1974 are unallowable.

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

4. Amend section 52.215-15 by revising the date of the clause and paragraph (b) to read as follows:

52.215-15 Pension Adjustments and Asset Reversions.

* * * * *

Pension Adjustments and Asset Reversions (Date)

* * * * *

(b) For segment closings, pension plan terminations, or curtailment of benefits, the amount of the adjustment shall be—

(1) For contracts and subcontracts that are subject to full coverage under the Cost Accounting Standards (CAS) Board rules and regulations (48 CFR Chapter 99), the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12);

(2) For contracts and subcontracts that are not subject to full coverage under the CAS, the amount measured, assigned, and allocated in accordance with 48 CFR 9904.413-50(c)(12), except the numerator of the fraction at 48 CFR 904.413-50(c)(12)(vi) shall be the sum of the pension plan costs allocated to all non-CAS covered contracts and subcontracts that are subject to Federal Acquisition Regulation (FAR) Subpart 31.2 or for which cost or pricing data were submitted; and

(3) Credited to the Government either as a cost reduction or by cash refund, at the option of the Government.

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(End of Clause)

[FR Doc. 03-1963 Filed 1-29-03; 8:45 am]

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