CAS Pension Harmonization ANPRM
(Advanced Notice of Proposed Rulemaking)

Office of Management and Budget

Office of Federal Procurement Policy

Cost Accounting Standards: Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006; Notice

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006.

ACTION: Advance Notice of Proposed Rulemaking.

SUMMARY: The Office of Federal Procurement Policy, Cost Accounting Standards Board, invites public comments concerning an Advance Notice of Proposed Rulemaking on the harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006.

DATES: Comments must be in writing and must be received by the date specified in the Federal Register Notice announcement of this Advanced Notice of Proposed Rulemaking.

ADDRESSES: The full text of the Advance Notice of Proposed Rulemaking, including the Board's response to public comments on the Staff Discussion Paper and the draft proposed amendments to Cost Accounting Standards 412 and 413, is available at: *http://www.whitehouse.gov/omb/procurement/casb/2008_anprm.pdf* and *http:// www.regulations.gov*

All comments to this Advance Notice of Proposed Rulemaking must be in writing. Due to delays in the receipt and processing of mail, respondents are strongly encouraged to submit comments electronically to ensure timely receipt. Electronic comments may be submitted in any one of three ways:

1. Comments may be directly sent via *http:// www.regulations.gov*—a Federal E-Government Web site that allows the public to find, review, and submit comments on documents that agencies have published in the Federal Register and that are open for comment. Simply type "CAS Pension Harmonization ANPRM" (without quotes) in the Comment or Submission search box, click Go, and follow the instructions for submitting comments;

2. Comments may be included in an e-mail message sent to *casb2@omb.eop.gov*. The comments may be submitted in the text of the e-mail message or as an attachment; or

3. Comments may also be submitted via facsimile to (202) 395-5105.

Be sure to include your name, title, organization, postal address, telephone number, and e-mail address in the text of your public comment and reference "CAS Pension Harmonization ANPRM" in the subject line. Comments received by the date specified above will be included as part of the official record.

Please note that all public comments received will be available in their entirety at *http://www.whitehouse.gov/omb/procurement/casb/index_public_comments.html* and *http://www.regulations.gov* after the close of the comment period.

FOR FURTHER INFORMATION CONTACT: Eric Shipley, Project Director, Cost Accounting Standards Board (telephone: 410-786-6381).

SUPPLEMENTARY INFORMATION

A. Regulatory Process

Rules, Regulations and Standards issued by the Cost Accounting Standards Board (Board) are codified at 48 CFR Chapter 99. The Office of Federal Procurement Policy Act, 41 U.S.C. 422(g), requires that the Board, prior to the establishment of any new or revised Cost Accounting Standard (CAS or Standard), complete a prescribed rulemaking process. The process generally consists of the following four steps:

1. Consult with interested persons concerning the advantages, disadvantages and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard.

2. Promulgate an Advance Notice of Proposed Rulemaking.

3. Promulgate a Notice of Proposed Rulemaking.

4. Promulgate a Final Rule.

This Advance Notice of Proposed Rulemaking is step two of the four-step process.

B. Background and Summary

The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board, is today releasing an Advance Notice of Proposed Rulemaking (ANPRM) on the harmonization of Cost Accounting Standards (CAS) 412 and 413 with the Pension Protection Act (PPA) of 2006 (Pub.L. 109-280, 120 Stat.780). The Office of Procurement Policy Act, 41 U.S.C. 422(g)(1), requires the Board to consult with interested persons concerning the advantages, disadvantages, and improvements anticipated in the pricing and administration of Government contracts as a result of the adoption of a proposed Standard prior to the promulgation of any new or revised CAS.

The PPA amended the minimum funding requirements and tax-deductibility of contributions to pension plans under the Employee Retirement Income Security Act of 1974 (ERISA). The PPA requires the Board to revise Standards 412 and 413 of the CAS to harmonize with the amended ERISA minimum required contribution not later than January 1, 2010.

Prior Promulgations

On July 3, 2007, the Board published a Staff Discussion Paper (72 FR 36508) to solicit public views with respect to the Board's statutory requirement to “harmonize” CAS 412 and 413 with the PPA. Differences between CAS 412 and 413 and the PPA, as well as issues associated with pension harmonization were identified in the Staff Discussion Paper (SDP). Respondents were invited to identify and comment on any issues related to pension harmonization that they felt were important. The SDP reflected research accomplished to date by the staff of the Board, and was issued by the Board in accordance with the requirements of 41 U.S.C. 422(g). The SDP identified issues related to pension harmonization and did not necessarily represent the position of the Board.

The SDP noted basic conceptual differences between the CAS and the PPA that affect all contracts and awards subject to CAS 412 and 413. The PPA utilizes a settlement or liquidation approach to value pension plan assets and liabilities, including the use of accrued benefit obligations and interest rates based on current corporate bond rates. On the other hand, CAS utilizes the going concern approach to plan

asset and liability valuations, *i.e.*, assumes the company (or in this case the pension plan and trust) will continue in business, and follows accrual accounting principles that incorporate long-term, going concern assumptions about future asset returns, future years of employees' service, and future salary increases. These assumptions about future events are absent from the settlement approach.

Public Comments

The Board received 18 public comments to the Staff Discussion Paper. These comments came from contractors, industry associations, federal agencies, and from the actuarial and legal professions. The Board appreciates the efforts of all parties that submitted comments and found the depth and breadth of the comments to be very informative. A summary and discussion follows in Section C – Public Comments to the SDP.

In addition to the public comments, this ANPRM reflects research accomplished to date by the staff of the Board in the respective subject area, and is issued by the Board in accordance with the requirements of 41 U.S.C. 422(g).

Conclusions

The Board believes that the accounting for pension costs for contract costing purposes should continue to reflect the long-term nature of the pension plan for a going-concern. The Cost Accounting Standards are intended to provide cost data not only to determine the incurred cost for the current period, but also to provide consistent and reasonable cost data for forward-pricing contracts over the near future. Financial statement accounting, on the other hand, is intended to report the change in an entity's financial position and results of operations during the current period. ERISA does not prescribe a unique cost or expense for a period. The minimum required contribution rules of ERISA, as amended by the PPA, instead require that the plan achieves funding of its current settlement liability within a short period of time. On the other hand, the ERISA tax-deductible maximum contribution is based on the plan's long-term benefit levels plus a reserve against adverse experience. ERISA permits the entity a wide contribution range that allows the company to set long-term financial management decisions on the funding of the ongoing pension plan.

The Board recognizes that contract cost accounting for a going concern must, nevertheless, address the risk associated with inadequate funding of a plan's settlement liability and therefore proposes

implementation of a minimum liability based on the accrued benefits valued based on corporate bond rates. Furthermore, harmonization with the PPA minimum required contribution, which is based on the ERISA "funding target" and "target normal cost," will help alleviate the disparity in timing between ERISA's minimum funding requirements and recognition of such required funding in contract costing. Once harmonization is achieved, maintaining the going concern basis for contract costing allows contractors to set long-term funding goals that avoid undue cost/contribution volatility.

The Board continues to believe that issues of benefit design, investment strategy, and financial management decisions for the pension plan fall under the contractor's purview. The Board also believes that the Cost Accounting Standards must remain sufficiently robust to accommodate evolving changes in financial statement reporting and theory as well as Congressional changes to ERISA.

After considering the effects of accelerating recognition of actuarial gains and losses, the Board proposes changing the amortization period for gains and losses to a 10-year amortization period from its current 15-year period to provide more timely adjustment of plan experience while not introducing unmanageable volatility. This shorter amortization period also more closely follows the 7-year period required by ERISA to fully fund the plan's settlement liability.

In assessing the potential for volatility that would adversely impact forward pricing, the Board noted that for pension plans that are close to being fully funded, the sudden and unpredictable elimination or emergence of significant pension costs has been problematic for many years. Accordingly, the Board proposes to revise the "assignable cost limitation" so that it does not apply until the actuarial value of assets equals or exceeds 125% of the actuarial accrued liability plus normal cost. In addition, the actuarial gains that give rise to surplus assets will be amortized over 10 years and will reduce the surplus in an orderly and timely fashion.

The Board proposes a specific transition method for implementing harmonization. This transition method would apply to all contractors subject to CAS 412 and 413 through full CAS-coverage or Federal Procurement Regulation (FAR) § 31.205-6(j). The proposed transition will phase-in revisions to the liability and normal cost measurement and to the amortization periods during the first 5 years as new contracts are priced and awarded so that the cost effects of harmonization are gradually recognized.

Benefits

The draft proposed rule being published today should harmonize the disparity between the PPA minimum contribution requirements and contract costing within a relatively short time frame. The draft proposed rule should provide relief for the contractors' concerns with indefinite delays in recovery of cash expenditures while mitigating the expected pension cost increases that will impact agency budgets. The draft proposed rule should also reduce cost volatility between periods and thereby enhance the forward pricing and budgeting process.

The draft proposed rule allows companies to use the same actuarial methods and valuation software for ERISA, financial statement and government contract costing purposes. Except for the interest rate, the same general set of actuarial assumptions can be used for all three purposes. This will allow agencies and government auditors to place reliance on data from ERISA and financial statement valuations, and allow contractors to avoid unnecessary actuarial effort and expense.

The proposed transition phase-in lasts for a specific 5-year period that tracks the typical contracting cycle. More importantly, the proposed transition phase-in should provide at least partial harmonization relief for contractors with contracts that are exempt from CAS-Coverage. At the same time the proposed phase-in provisions are intended to make the possible cost increases due to harmonization more manageable for the procuring agencies.

<u>Goals for Harmonization</u>

This draft proposed rule is based upon the following goals that the Board established for achieving pension harmonization and transition:

1) **Harmonization Goals**

   a) Minimal changes to CAS 412 and 413.

   b) No direct adoption of the Employee Retirement Income Security Act of 1974, (ERISA) as amended by the Pension Protection Act (PPA), to avoid any change to contract cost accounting without prior CAS Board approval since Congress will amend ERISA in the future.

   c) Preserve matching of costs with causal/beneficial activities over the long-term.

d) Reconcile minimum required contributions with contract cost recognition over a reasonable time period.

e) Mitigate volatility (enhance predictably).

f) Permit reasonable surplus assets and voluntary prepayments as a "stability reserve."

g) Make "user-friendly" changes (avoid complexity to the degree possible).

2) Goals for Transition to Harmonization

a) Minimize undue immediate procurement budget impact.

b) Address pre-PPA Harmonization accumulated prepayment credits.

c) Transition should work for both CAS & FAR contractors.

Summary Description of Draft Proposed Standard

This draft proposed rule makes nine general changes to CAS 412 and 413 that are intended to harmonize the CAS with the PPA minimum required contributions while controlling cost volatility between periods. These general changes are:

1) Recognition of a "minimum actuarial liability." CAS 412 and 413 continue to measure the actuarial accrued liability based on long-term, "best-estimate" actuarial assumptions, projected benefits and the contractor's established immediate gain actuarial cost method. However, the actuarial accrued liability must be adjusted to recognize the excess of the "minimum actuarial liability" for the period. The minimum actuarial liability definition is consistent with the definitions of the accumulated benefit obligation under Statement of Financial Accounting Standards No. 87 (FAS 87) and the PPA funding target. The normal cost must be similarly adjusted in any period that the actuarial accrued liability is adjusted.

The draft proposed rule does not require a change to the contractor's actuarial cost method used to

compute pension costs for CAS 412 and 413 purposes. Therefore, any change in actuarial cost method, including a change in asset valuation method, would be a "voluntary" change in cost accounting practice.

2) Mandatory Prepayment Credits. The draft proposed rule distinguishes between mandatory and voluntary prepayment credits. A mandatory prepayment credit is created when the ERISA minimum required contribution, reduced by any carry-over or prefunding balance, exceeds the assigned pension cost. All other excess contributions will be treated as voluntary prepayment credits. 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.

The PPA has exacerbated the frequency and degree of mismatch between the ERISA minimum required contribution and the assigned pension cost. This mismatch creates prepayment credits and is at the crux of the contractor's cash flow concerns. To address this concern, the Board is proposing that such mandatory prepayments be credited to a "mandatory prepayment account" and that timely recovery be accomplished by allocating an amount at least equal to a "mandatory prepayment charge." The "mandatory prepayment charge" is calculated as the amount necessary to amortize the mandatory prepayment credit over 5 years. To the extent that the mandatory prepayment charge is applied towards funding of the assigned cost, there is no need for any special allocation of the charge. But to ensure that the full mandatory prepayment charge is allocated, in any year that the amount of the mandatory prepayments applied to funding of the assigned pension cost and allocated to cost objectives is less than the mandatory prepayment charge, the remaining portion of the charge will be allocated to cost objectives as an incremental component of pension cost. It will separately be assigned to segments and cost objectives based on the factors used to determine pension costs, such as salaries for pay-related benefits and headcounts for non pay-related benefits. This amortization process is intended to balance in an orderly and manageable manner, the contractors' concern over negative cash flow and the Government's concern over an adverse impact on program budgets.

The draft proposed rule effectively treats the mandatory prepayment charge as a guaranteed minimum amount that will be allocated to cost objectives. However, the full mandatory account balance is available to fund the pension cost assigned to the period. The amount of mandatory prepayments used to fund the assigned pension cost is referred to as the "applied mandatory prepayment." To the extent that the applied mandatory prepayment credit is greater than the mandatory prepayment charge, the amortization of the mandatory prepayment account is accelerated. Therefore, the draft proposals requires that the

excess be applied against each unamortized mandatory prepayment base in the order in which it was created, and that the amortization installment that forms the mandatory prepayment charge be recalculated based on the remaining unamortized balance and remaining amortization years.

This draft proposed rule continues the requirement that the assigned pension must be funded to be assignable. To harmonize with the minimum funding requirements of ERISA, this draft proposal sets forth a hierarchy of the order in which funding sources are considered. The first source of funding considered is the minimum required funding amount since this funding is imposed by ERISA. Then, in any subsequent period that the assigned pension cost exceeds the ERISA minimum required contribution, the Board proposes that the mandatory prepayment account balance be applied to such excess before any portion of the voluntary prepayment credits are considered. Finally, only after the minimum required funding amount, mandatory prepayment account and voluntary prepayment account are exhausted are any additional contributions over the minimum required funding amount required to fund the assigned pension cost.

Under this draft proposed rule, the interest on the mandatory prepayment account balance, *i.e.*, accumulated value of mandatory prepayment credits, will continue to accrue at the long-term interest assumption rate, just like other amortization installment amounts assigned to periods by the CAS. This is consistent with the CAS method for recognition of the unfunded actuarial liability.

3) Accelerated Gain and Loss Amortization. The draft proposed rule accelerates the assignment of actuarial gains and losses by decreasing the amortization period from 15 to 10 years. This accelerated assignment will reduce the delay in cost recognition and is consistent with the shortest amortization period permitted for other portions of the unfunded actuarial liability (or actuarial surplus).

4) Revision of the Assignable Cost Limitation. The draft proposed rule should lessen cost volatility between periods by increasing the assignable cost limitation to permit the accumulation of a reasonable asset surplus. The assignable cost limitation would be based on 125% of the actuarial accrued liability plus normal cost less the actuarial value of assets.

5) Mandatory Cessation of Benefit Accruals. This draft proposal will exempt any curtailment of benefit accrual required by ERISA from immediate adjustment under CAS 413-50(c)(12).

6) Projection of Flat Dollar Benefits. The draft proposed amendments will allow the projection of increases in specific dollar benefits granted under collective bargaining agreements. The recognition of such increases will place reliance on criteria issued by the Internal Revenue Service (IRS). As with salary projections, the rule will discontinue projection of these specific dollar benefit increases upon segment closing, which uses the accrued benefit cost method to measure the liability.

7) Asset Values and Present Value of Contributions. For nonqualified defined benefit plans, this draft proposed rule discounts contributions at the long-term interest assumption from the date paid, even if made after the end of the year. For qualified defined benefit plans, this draft proposal would accept the present value of accrued contributions and the market value (fair value) of assets recognized for ERISA purposes. Using the ERISA market value of assets will avoid unexpected anomalies between ERISA and the CAS, as well as support compliance and audit efforts. The market and actuarial values of assets should include the present value of accrued contributions. The Board notes that FAR 31.205-6(j)(2)(iii) governs the allowability of any interest charge due to delayed funding.

8) Interest on Voluntary Prepayments and Unfunded Pension Costs. 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 unfunded and/or unallowable pension costs accounted for under 9904.412-50(a)(2) 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.

9) Transition Phase-In Mitigates Initial Increase in Contract Price. To allow time for agency budgets to manage the possible increase in contract costs and to mitigate the impact on existing non-CAS covered contracts, the changes to CAS 412 and 413 are phased-in over a period of years that roughly matches the typical contracting cycle. The proposed phase-in allows the cost impact of this draft proposal to be equitably recognized in the pricing of CAS-covered and FAR contracts alike. Any increase in the actuarial accrued liability due to the minimum actuarial liability will be phased in over a 5-year period at 20% per year, i.e., 20% of the difference will be recognized the first year, 40% the next year, then 60%, 80% and finally 100% beginning in the fifth year. The phase-in of the minimum actuarial liability also applies to segment closing adjustments. The amortization period for actuarial gains and losses will be 14 years for the first year, reducing by one for each succeeding year until reaching 10 years. Likewise, the

amortization period for minimum mandatory prepayment credits will be 12 years for the first year, reducing down by two each succeeding year until reaching 5 years.

C. Public Comments to Staff Discussion Paper

The full text of the public comments to the SDP is available at: *http://www.whitehouse.gov/omb/procurement/casb/index_public_comments.html* under "Combined Public Comments on the Staff Discussion Paper on the Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006," and *http:// www.regulations.gov.*

Summary of Public Comments

The public comments included a broad range of views on how to harmonize CAS with the PPA. At one extreme, one commenter believed that the Board should do nothing as the existing CAS rules are already harmonized with the PPA. At the other extreme, others believed that CAS 412 and 413 should be amended to adopt the actuarial assumptions and measurement techniques used to determine the PPA minimum required contribution. In any case, there was overall consensus that any amendments to CAS 412 and 413 should apply to all contractors, whether CAS-covered or not.

Most of the public comments expressed concern that the disparity between CAS and the PPA has the potential to cause extreme cash flow problems for some Government contractors. Commenters generally agreed that the minimum required contribution must be recognized in contract costing on a timely basis.

Industry and professional groups generally agreed that Section 106 of the PPA requires CAS 412 and 413 to be revised to harmonize with the PPA minimum required contribution. However, there were varying views on how to best accomplish that goal. Many commenters suggested that the Board seize the opportunity offered by harmonization to bring the CAS rules more in line with the evolving views of financial statement disclosure of pension obligations, minimum funding adequacy to protect the plan participants and the Pension Benefit Guarantee Corporation (PBGC), and financial economics regarding the appropriate use of corporate resources and shareholder equity. Rather than merely amending the existing rules, the public comments suggested that a fresh look should be taken by the Board to balance and reconcile the competing interests of stakeholders and the intent of the various statutes.

Others argued that there is no mandate for the Board to address any issue beyond the PPA minimum required contribution. These commenters believed that any other issues should be addressed by the Board in a separate case. On the other hand, there was not consensus on how far the Board should go beyond the requirement to merely harmonize with the PPA minimum required contribution, e.g. should the Board also consider the PPA's revisions to maximum tax deductible limits.

For the most part, industry comments supported the adoption of the PPA minimum funding provisions including the provisions related to "at-risk" plans. They believe that directly adopting the PPA minimum funding provisions will preserve the equitable principle of the CAS whereby neither contractors nor Government receives an unfair advantage. They expressed concern that if the Board does not fully adopt the PPA minimum funding provisions, the Government will have an unfair advantage because the PPA compels the contractors to incur a higher cost than they can allocate to government contracts and recover currently, thus, creating negative corporate cash flow. They noted that although the prepayment provision in the current CAS is meant to mitigate this situation, the cost methodology under the PPA is so radically different that the prepayment provision in CAS 412 has negligible impact in providing timely relief to the contractor from this negative cash flow.

The views of one federal agency on harmonization differed from those of industry and opined that no revision to CAS was necessary to harmonize with the PPA. This commenter argued that: (i) harmony is already achieved through prepayments credits; (ii) adopting the PPA funding rules will run counter to uniform and consistent accounting; (iii) adopting the PPA requirements weakens the causal/beneficial relationship between the cost and cost objective; and, (iv) adopting the PPA requirements will increase cost volatility. The commenter expressed its belief that the purposes of the PPA, which are to better secure pension benefits and promote solvency of the PBGC, are different than the purposes of CAS. They also believed that since CAS does not undermine the purposes of the PPA the two are in harmony.

Responses to Specific Comments

1. Applicability of Harmonization Rule. The SDP asked whether any revisions should apply 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 of the PPA.

Comment: All respondents shared the belief that harmonization required by Section 106, should apply to all contracts which are directly or indirectly subject to the principles of CAS 412 and 413. The industry

associations reminded the Board that the cost accounting standards are "designed to achieve uniformity and consistency in the cost accounting practices governing measurement, assignment, and allocation of costs to contracts with the United States Government." 48 CFR Part 9901.302(b). They believe that separate rules would create unnecessary complexity, confusion, be difficult to administer, and inherently unfair to competition between organizations of varying size. One commenter observed that the government will lose comparability between larger and smaller contractors subject to different versions of CAS. Another industry association asserted that it seems counterproductive to impose different systems, depending on the characteristics of a contractor or government plan, when the intent is harmonization. A contractor noted that the CAS has never had a separate set of rules for large contractors than for small contractors. Many commenters also identified the concern that eligibility under Section 106 can change, depending upon annual contract sales mix and merger and acquisition activities, thereby rendering forward pricing proposals more speculative and CAS coverage to subcontractors more uncertain.

Response: The Board agrees there should be a single set of rules. The draft proposed Harmonization Rule amends CAS 412 and 413 as they apply to all cost-based contracts. Moreover, the proposed transition provisions of 9904.412-64.1 and 9904-413-64.1 gradually phase-in the effect of the changes in cost accounting practice over 5 years, which is the typical contracting cycle, and limit the cost increase for relief for existing contracts that are not subject to CAS-coverage.

2. Role of CAS in implementing tax policy and protecting pension plan solvency. The SDP inquired to what extent, if any, should the Board revise the CAS based on the PPA rules established to implement tax policy and protect pension benefit solvency.

Comments: Industry and professional associations and contractors remarked that the mandate to harmonize CAS 412 and 413 pursuant to PPA Section 106 refers to the minimum required contribution under PPA rather than to tax policy. One of these commenters observed, "tax policy should not be a concern of the Board except to the extent that the CAS rules should not contravene established tax policy."

Their consensus is that the solvency of the pension plan or the PBGC is beyond the purview of the Board. Rather, the PPA addresses these issues and government contractors will have to abide by the PPA rules. However, as pointed-out by one commenter:

> The PPA was enacted to help ensure the solvency of pension plans and the PBGC. Adopting harmonization rules that ensure the assignability of minimum required contributions under the PPA should be sufficient to support the intent of the PPA to bolster the security of pension plans. However, failure by the Board to ensure such assignability would undermine the intent of Congress in enacting the PPA.

Response: The Board agrees the implementation of tax policy or protection of benefit solvency is beyond the scope and authority of the CAS. The Board also reiterates its long standing objective that CAS 412 and 413 should not conflict with the provisions of ERISA. However the ERISA minimum required contribution only ensures that the current settlement liability is funded in a timely fashion, but is not a measurement of the long-term cost for a going concern. Pensions are a “pay me now or pay me later” undertaking. No matter what basis is used to measure the period cost, in the end the total long-term benefit liability and associated administrative expenses must be liquidated by contributions and investment earnings. Recognizing only a current benefit pension cost now will cause higher pension costs later as future benefits accrue and if the plan has periods of adverse experience.

One of the basic differences between the PPA and the CAS is that the PPA ignores long-term investment policy and earnings expectations, relying instead on current market settlement rates. The CAS recognizes future investment results based on long-term market expectations and tempered by the contractor’s investment policy.

Under economic environments with relatively low yield rates on corporate bond, the pension cost assigned to period under the current CAS 412 and 413 may be less than the minimum required contribution. This does not constitute a conflict with ERISA – The contractor can fund the minimum required contribution and also comply with the CAS. The amount funded in excess of the assigned pension cost is not immediately recognized for contract costing purposes, but instead is carried forward as a prepayment credit until it is used to fund future assigned pension costs. The Board acknowledges that such situations create a current period negative cash flow for the contractor, which if persistent may create a disincentive for continuing the pension plan and thereby contravene the intent of the PPA or discourage companies from doing business with the Government.

Conversely, when yield rates on corporate bond are relatively high, the pension cost assigned to period under the current CAS 412 and 413 can be more than the minimum required contribution. In fact, the assignment of pension costs in excess of the tax-deductible maximum was one of the key concerns

addressed in the 1995 amendments to CAS 412 and 413. Assigning cost in excess of the minimum required contribution does not conflict with ERISA, the requirement to fund the higher pension cost causes the contractor to accumulate a prepayment buffer in the pension plan. Enabling the accumulation of assets above the minimum required level creates a reserve against future adverse experience that certainly supports the intent of PPA to enhance benefit solvency and protect the PBGC.

3. Responsibility of CAS 412 and 413 to support the intent of the PPA. Commenters were asked if they believed that the current CAS 412 and 413 substantially met the Congressional intent of the PPA to protect retirement security, to strengthen funding and ensure PBGC solvency.

Comment: There was consensus in the opinion of industry and professional associations and contractors that current CAS 412 and 413 provisions do not meet Congressional intent to protect retirement security and ensure solvency of the PBGC.

One commenter noted that:

> Clearly the purpose of the PPA was to accelerate pension funding with a targeted minimum level of assets that (at a minimum) equals the value of accrued benefits determined using approximate market assumptions. Most notably, under CAS 412 and 413, the interest rate assumption is generally required to be reflective of expected long term returns on the plan's invested assets while under the PPA the interest rate assumption is reflective of the market yields of investment quality corporate bonds of appropriate duration. This disparity in interest rates may result in mismatch of pension plan funding with reimbursement from government contracts. Inability to absorb negative cash flow might motivate contractors to underfund, reduce, or eliminate their pension plans.

One of the federal agency commenters believes that:

> The Government contractors' defined benefit pension plans are adequately funded. Further, while CAS measures and assigns pension costs on an on-going concern basis, it provides for a pension cost adjustment on a termination basis when the obligation is being settled. Accordingly, 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.

However, another commenter asserted that:

> The CAS concepts of segment closing, plan termination, and curtailment of benefits do not relate to the solvency of the company or the pension plan. While CAS 413 provides for a measurement of the assets and liabilities of the pension, the resulting difference "represents an adjustment of previously-determined pension costs" [CAS 413.50(c)(12)]. This adjustment has no effect on the solvency of the pension plan itself, because it does not obligate or compel the contractor to either contribute to or withdraw assets from the pension trust. Without affecting the actual assets in the pension trust, the CAS provisions have no affect on the solvency of the pension plan itself.

Response: As discussed above, implementing tax policy aimed to improve the minimum required funding of a pension plan is outside the purview of the CAS. A greater concern is that the minimum required contribution is measured using corporate bond yield rates tied to current market conditions. This measurement introduces market volatility and ignores the contractor's investment strategy for pension funding. The minimum required contribution only guards against a current shortfall in assets compared to the current settlement liability. The long-term, going concern basis used by the CAS anticipates the future growth of the benefit liability, produces relatively stable liability values and pension costs, and recognizes difference in the assumed versus actual investment returns as they occur. An essential difference between ERISA and the CAS, is that the cost data measured in accordance with CAS 412 and 413 is used to price contracts over many years, while ERISA is focused on the achievement of minimum funding in the market environment of a particular year.

The comments concerning whether benefit solvency is achieved through the segment closing / plan termination provisions of 9904.413-50(c)(12) bring out two important observations. First, because the segment closing adjustment charge is paid to the contractor, there is no assurance that the funds will ever be deposited into the trust and benefit the employees who performed work under Government contracts – This is counter to the Board's stated goal of matching costs with causal/beneficial activities. Secondly, if assets are not accumulated towards the current settlement liability, the procuring agencies could face a large, unbudgeted cost. Taken together, these points suggest that contract costing should not ignore the current settlement liability, and therefore, the Board proposes that the actuarial accrued liability be subject to adjustment based on a minimum actuarial liability.

4. The Need for Harmonization (focus on Harmonization). In the SDP, commenters were asked whether 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.

Comment: There was uniformity in the belief that Section 106(d) of the PPA required the Board to take some action to harmonize the minimum required contribution under ERISA with government reimbursement of the assigned and allocated pension cost determined in conformity with CAS 412 and 413. At present there are differences between PPA minimum required contributions and CAS assigned and allocable costs. One commenter stated that, "we do not recommend that the CAS cost be equal to the PPA minimum required contribution as this would almost certainly increase volatility and make it difficult to ensure costs are properly assigned to cost accounting periods." Another commenter observed that "today, contractors often find that statutory contribution requirements are not within the ranges of assignable costs permitted under CAS. Without taking into account the maximum deductible limits in the harmonization process the likelihood of the inconsistencies increase."

Some commenters also suggested that the Board take this opportunity to generally review CAS 412 and 413.

Response: The Board believes that some revision to CAS 412 and 413 will be necessary to "harmonize" the assigned and allocated pension cost with the PPA's minimum required contribution. Congress granted the Board the sole authority to determine how harmonization is accomplished. The Board believes that the measurement, assignment and allocation provisions of the CAS must not be linked or dependent upon the changeable provisions of tax policy. In considering the harmonization revisions, the Board is mindful of the impact of tax-policy on the pension funding decisions and requirements that fall on Government contractors.

Because of the potentially broad scope of pension harmonization and the time limit imposed by Section 106 of the PPA, the Board has limited this case to harmonization issues only. The Board continues to welcome public comments on other issues pertaining to CAS 412 and 413, but issues outside the scope of harmonization must be addressed in a separate case.

5. Potential for ERISA penalties under current CAS 412 and 413. The SDP inquired whether the current CAS 412 and 413 would result in a contractor incurring a penalty under ERISA in order to receive full reimbursement of CAS computed pension costs under Government contracts.

Comment: Respondents generally agreed that there are no specific ERISA penalties created by the current CAS 412 and 413. Actuaries noted that current CAS does not require funding in excess of the ERISA tax deductible limits which protects contractors from imposition of excise taxes. One commenter opined that "if a contractor funds only the CAS assignable cost and the CAS assignable cost is lower than the minimum required contribution after taking into account any existing Credit Balance, then the contractor would incur penalties under ERISA." Another commenter observed that

> When a contractor makes contributions that exceed the CAS cost, the prepayment credit provision in CAS provides a mechanism for eventual recovery of amounts funded into the pension plan. Conversely, the current CAS provisions for assignable cost deficits and assignable cost limitations provide for equitable cost recovery when CAS cost exceeds the amount of funding permitted under ERISA.

The consensus is that the difference between ERISA pension funding and government contract cost reimbursement creates a significant cash flow problem Contractor cash flow problems are expected to worsen under PPA from anticipated, increased plan funding requirements. One commenter was concerned that "while under current CAS rules such contributions are treated as prepayment credits and are accumulated with interest, differences in the measurement of costs under the PPA rules and the current CAS rules could mean their assignability, and hence their recovery, may be delayed indefinitely."

Response: As expressed earlier, the Board believes that the current CAS 412 and 413 do not conflict with the provisions of ERISA. While the existing prepayment credit provisions ensure that funding in excess of the assigned cost is carried forward, the dominant theme of the contractors' concerns is the timeliness of cost recognition vis-à-vis their cash outlays. While an extended delay of cost recognition is not a penalty per se, the Board acknowledges that an unreasonable period of delay may financially disadvantage the contractor and be an impediment to future contracting. The draft rule being proposed today will recognize prepayment credits caused by the PPA minimum required contribution in contract costs within a reasonable time period.

6. Relationship of CAS assigned cost to ERISA's range of contributions. The Board asked 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. The Board also asked whether the ERISA credit balances (carryover and prefunding balances) should be considered in revising CAS 412 and 413.

Comment: There were divided opinions over the appropriate basis for the contribution needed to annually fund a pension plan. Many respondents interpret the objective of harmonization as requiring direct recognition of the PPA minimum required contribution. Whereas others favor a means of reconciling the minimum required contribution and CAS cost assigned cost. Some commenters urged the Board to retain the current requirement that the CAS cost must not be less than zero.

One commenter stated:

> The Board does not need to ensure that the CAS assignable costs are at least as much as the PPA minimum required contribution. However, it is equitable for differences between CAS assignable costs and the minimum required contribution to be reconciled in a reasonable period of time. To help achieve this, the Board could consider imposing a limit to the level of Prepayment Credits that are a direct result of minimum funding requirements in excess of CAS assignable costs. For example, if the Prepayment Credits exceed 1% of assets, then the excess Prepayment Credits could be amortized over 7 years and the amortization amount would be included in the CAS assignable cost for the year.

While there was scant concern with the tax deductible maximum contribution, which has been significantly increased by PPA, the commenters believed that the CAS cost should continue to limit the assigned cost so that it does not exceed this upper limitation. One commenter noted: "Section 106 of the PPA requires the Board to revise CAS 412 and 413 to harmonize with the minimum contribution under PPA. It would probably also make sense to follow the current CAS and to limit the assignable cost in any year to the maximum tax deductible amount plus any prepayment credits."

One commenter suggested that:

> CAS rules have a different purpose - to promote uniformity and consistency among contractors. Uniformity and consistency are not enhanced by providing wide discretion in reimbursable costs. The Board should retain the concept of CAS 412 and 413 that provides a specific assignable cost for an accounting period. Contributions in excess of this amount should continue to result in prepayments, and contributions less than this amount can be reimbursed to the extent previous prepayments are available.

Another commenter supported this approach in remarking, “We believe the Board should retain the concepts of assignable cost deficits and prepayment credits as exist currently in CAS when they consider the additional elements for determining CAS cost from the harmonized basis.”

The consensus opinion is that CAS assignable cost should be determined without respect to ERISA credit balances. Two industry associations commented that “ERISA credit balances from pre-funding and CAS prepayment credits serve inherently different purposes and cannot be fully harmonized to properly measure and assign pension costs for CAS. Accordingly, we recommend the Board not consider harmonizing the concepts of CAS prepayment credits and ERISA credit balances.” Another commenter agreed that ERISA credit balances should not be considered in revising CAS 412 and 413 since they reflect the cumulative funding in excess of the minimum required contribution rather than the historical differences between the minimum required contribution and the CAS cost.

Response: The Board agrees that the purpose of the CAS is to provide “a specific assignable cost for an accounting period” based on criteria that promote “uniformity and consistency among contractors.” This draft proposed rule retains the existing criteria for measuring and assigning pension costs that limit period assignment to a zero dollar floor and a ceiling which is the sum of the tax-deductible maximum plus the value of the mandatory and voluntary prepayment accounts.

The Board observes that the ERISA “credit balance” serves to reconcile funding with the minimum required contribution, and that reconciliation is generally unrelated to the assignment of pension costs for contract costing purposes. For CAS 412 and 413 purposes, the reconciliation of funding with the assigned cost is accomplished by prepayment credits and the separate identification of unfunded assigned costs. However, use of the “credit balance” to reduce current period minimum required contribution is subject to the contractor’s unilateral financial management decision for the current and future periods. Therefore, in determining the minimum required funding amount this draft proposed rule reduces the minimum required contribution by any available credit balances. The minimum required funding amount is not reduced for credit balances that must be waived due to the plan’s funding level. Within this draft proposed rule, the ERISA minimum required contribution net of any prefunding or other credit balances is referred to as “minimum required funding.”

This rule proposes that the full amount of any prepayment credit created by the excess of the PPA minimum required contribution over the assigned cost be recognized as mandatory prepayment credit and assigned to future periods as a mandatory prepayment charge. The Board seeks additional input from the

public whether only the amount of mandatory prepayment credits above some threshold, i.e., 1% of assets or liability, should be expressly reassigned.

7. Use of PPA measurement and assignment methods and techniques. The SDP asked to what extent, if any, revisions to CAS should be based on the measurement and assignment methods of the PPA. Public input was also requested on whether the Board should either (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.

Comment: Industry and professional associations and contractors resoundingly recommend that the Board utilize the PPA measurement and assignment criteria as the baseline for CAS assignment and measurement of defined benefit pension plan costs. One contractor commented:

> We recommend using the same underlying methods and assumptions for developing the PPA minimum contribution and the components of the CAS annual cost. Whatever rate curve the contractor uses to develop the PPA's funding target will also be used to develop the CAS liability. This will be true even if the contractor must use the PPA's "at risk assumptions". The CAS liability and normal cost . . . would be determined using the same method and assumptions and will be equal to the liability amounts used in the PPA calculations.

Another commenter "urges the CASB to adopt full harmonization of CAS 412 and 413 with respect to the definition and measurement requirements of PPA, by adopting the PPA actuarial assumptions for CAS measurement purposes." An actuarial firm opined that "to minimize differences between minimum funding requirements and CAS assignable costs, CAS should reflect the measurement and assignment methods under the PPA as much as possible. This includes recognizing the target liability and normal cost, respectively, and adopting the seven year period for amortizing the unfunded liability."

One commenter observed that:

> Under PPA we will be required to value the pension plan liabilities using a Corporate Bond discount rate basis and specified mortality tables. The discount rate under PPA may be 200 or more basis points lower than the current CAS funding rate which is based on the "best estimate"

> of the long-term investment returns for the pension trust investments. The result will be a much higher liability amount for the plan calculated under the PPA assumptions, and a PPA minimum required contribution well in excess of the CAS amounts for many years to come. If the CAS rules are changed to allow (or require) the use of the same liability determination, including discount rate and mortality assumptions as will be required under PPA, most of the other differences between CAS and PPA annual cost determinations would be viewed as minor.

Response: The Board believes that adopting the PPA assumptions and methods or the PPA funding target and target normal cost would make the assigned pension cost effectively equal to the PPA minimum required contribution. As previously noted, the Board believes the minimum required contribution is an inappropriate measure of the full, long-term cost of the pension plans. The Board is concerned that accepting the ERISA minimum funding measurements of the liability and normal cost would subject contract costs to potential volatility. But more importantly, if the measurement and assignment of pension costs is tied to ERISA, the measurement and assignment methods and criteria would have to be reviewed and possibly amended every time Congress enacts changes to ERISA.

The existing CAS permit contractors to establish their cost accounting practice based on the actuarial cost method that best suits their pension funding strategy and goals, as well as the individual features of their pension plan. Under the PPA, the minimum required contribution must be determined using the accrued benefit cost method (also known as the traditional unit credit cost method) and the PPA tax-deductible maximum contribution mandates the use of the projected unit credit cost method (with benefit projections), which both satisfy CAS 412. However this "one-size fits all" approach may not be appropriate for all defined benefit plans. Furthermore, under the proposed revisions to CAS 412, contractors could still use entry age normal cost method for determining their long-term funding goals and contract costs. The draft proposed rule does not limit the contractor's ability to choose the immediate gain actuarial cost method that best serves its unique pension funding goals.

8. "Going Concern" versus "Settlement" Measurement of the Liability. The SDP asked whether the Board should retain the current "going concern" basis for the measurement and assignment of the contract cost for the period, or revise CAS 412 and 413 to measure and assign the period cost on the "liquidation or settlement cost" basis of accounting for Government contract costing purposes.

Comments: The majority of recommendations from industry and professional associations expressed their belief that the "going concern" basis for measurement and assignment of contract costs is

fundamental to both CAS and PPA and should be retained. The comments from the actuarial profession tended to view the PPA funding rules as "going concern" rules. One of these commenters observed that:

> While the funding rules under PPA moved towards a termination approach for poorly funded plans and a settlement approach for all other plans, the PPA is not requiring plan sponsors to fund their plans on a termination or settlement basis. When a plan is "at risk," the PPA requires the plan to be treated as a plan that has a likelihood of no longer being a going concern and is about to be terminated. As a result, the minimum funding requirements are higher to reflect the higher costs associated with plan termination. However, it should be noted that while the funding rules under PPA moved towards a termination approach for poorly funded plans, actual termination costs would be higher than those measured under the PPA. And for plans that are not poorly funded, while the funding rules moved towards a settlement approach, actual settlement costs would be higher than those measured under the PPA.

On the other hand, contractors tended to view PPA on a basis other than "going concern." One contractor commented that "the PPA falls short of going concern accounting in that it fails to take into account future salary escalation in the determination of the cost of benefits accruing in the current period." Another stated:

> Using the existing definition of going concern, where assets are smoothed considerably and assumptions reflect a very long-term view that is likely to be overly optimistic in today's environment, we cannot recommend the Board retain such a view. We recommend the Board consider a basis between the two extremes of the ongoing concern and the liquidation (or settlement), such as a market-based basis which will allow the achievement of harmonization as mandated while allowing the Board flexibility to mitigate volatility.

On the other hand, a commenter observed:

> It is clear that the PPA's minimum funding requirements will increase the volatility of minimum required contributions. These requirements and outcomes have been mandated by Congress, through the PPA, for contributions contractors must make. If CAS 412 and 413 do not allow for reimbursement for more than the minimum funding requirements under the PPA, the contractor is unable to develop a contribution strategy that will minimize this volatility like is done under pre-PPA and existing CAS. CAS 412 and 413 harmonization needs to provide the flexibility to

contractors to permit a contribution strategy over the long term that will minimize volatility for both the contractor and the government.

Response: The Board continues to believe that for contracting costing purposes, pension costs must be based on "going concern" measurement and assignment methods and criteria. CAS 412 and 413 will continue to require measurement of the actuarial accrued liability and normal cost using long-term, "best-estimate" actuarial assumptions and recognize projected benefit levels. Such measurements diminish cost volatility between periods, enhance predictability for forward pricing and provide a better matching of costs with activities over extended periods.

That said, the Board views the PPA funding target, as well as the FAS 87 accumulated benefit obligation, as approximations of the current market-related settlement liability for benefits, ignoring the administrative expenses associated with actual settlements. While the Board believes that the existing long-term, "going concern" measurement basis of the CAS provides full and adequate funding of the pension liability over the long haul, it would be imprudent not to consider adequate funding of the current settlement liability. The Board notes that the recognition of minimum pension obligation as a liability is mentioned in FAS 87 and as long ago as Accounting Research Bulletin No. 47, *Accounting for Costs of Pension Plans,* published in 1956. Accounting Principles Board (APB) Opinion 8, *Accounting for the Cost of Pension Plans*, which was used as the basis for original CAS 412 and 413 required that "if the company has a legal obligation for pension cost in excess of amounts paid or accrued, the excess should be shown in the balance sheet as both a liability and a deferred charge."

Accordingly, the draft rule being proposed today begins to recognize a minimum actuarial liability based on benefits accrued to date and current settlement rates of corporate bonds of durations that match the expected benefit payouts. The Board believes that the liability measured by the PPA funding target will comply with the proposed definition of the minimum actuarial liability. The draft proposed rule also recognizes a minimum normal cost measured on the same basis. By adding this floor to the liability and normal cost basis, the Board expects that harmonization of the assigned cost with minimum required contributions will be improved. Furthermore, ensuring that assigned costs during the course of Government contracting will adequately fund the settlement liability should minimize the risk of large deficits when a segment closing or plan termination occurs.

For plans, such as cash balance plans, whose liability is less influenced by future salary levels, the introduction of a minimum actuarial liability will enhance the probability that the liability for settlement

of the account balances is adequately and appropriately recognized during the periods of contract performance.

a. **Basis for Measurement - Interest Assumption.** The SDP asked what basis for setting interest rate assumptions for measuring the pension obligation would best achieve uniformity and/or the matching of costs to benefits earned over the working career of plan participants. The public was also asked to what extent, if any, should the interest rate assumption reflect the contractor's investment policy and the investment mix of the pension fund?

Comments: The consensus of respondent industry and professional associations and contractors is that the PPA interest rate should be used for CAS cost calculations. One commenter opined that:

> … requiring all contractors to use the same basis for setting the interest rate will provide the most uniformity. Current CAS rules allow contractors to use their "best estimate." Using the PPA methodology will reflect the duration of each contractor's actual obligation, thus providing greater uniformity and consistency than current methodology. Using a high quality yield curve to determine the rate also provides a meaningful and consistent measure of obligations that conforms to broadly accepted measures of establishing current value of future cash flows.

Another commenter observed that:

> CAS 412 and 413 should adopt the interest rates employed by the PPA. If so adopted, CAS interest rate assumptions do not need to take into account either the contractor's investment policy or the investment mix of the pension fund. If the contractor's investment policy consistently achieves results better than the PPA assumed rates, the cost and volatility will be reduced for the contractor and for the government because of increased value in the assets being used to fund the liabilities at plan measurement dates.

Response: The Board believes that the measurement and assignment of pension cost will continue to be based on reasonable, long-term assumptions. Unlike the CAS, the purposes of the PPA minimum required funding and generally accepted accounting principles (GAAP) expense disclosures are unconcerned with cost predictability and stability across periods. The PPA is concerned that plan assets can adequately liquidate the settlement liability under current market conditions. GAAP is concerned with reporting the results of corporate operations during the current period, including changes due to

market conditions. CAS 412 and 413 are concerned with (i) assigning pension costs to periods that reflect the going-concern nature of the contractor and pension plan, (ii) the long-term pension funding and investment decisions of the contractor sponsoring the plan, and (iii) minimizing volatility to enhance predictability for forward pricing.

While the receipt of future Government contracts is not guaranteed, generally, companies subject to CAS 412 and 413 through full CAS-coverage or through FAR 31.205-6(j) have a contractual relationship with the Government that spans many years, or even decades. It is inappropriate for and disruptive to the contract pricing process to introduce cost fluctuations due to changing market conditions. Instead, the appropriate measurement and assignment of pension cost should reflect the best-estimate of long-term investment returns. As for recognition of future investment gains, the CAS generally require that gains or other credits be recognized when reasonably foreseeable.

The Board is concerned that the current level of corporate bond rates, which have persisted during the recent period, might be lower than the rates that historical data would suggest such rates to be in the long run. Thus it is possible that there will be many periods in which a long-term interest assumption for a going concern will provide more adequate funding of the long-term cost of the pension plan.

This draft proposed rule makes no change to the criteria for setting the interest rate assumption. The consideration of the duration of benefit liabilities in setting interest assumption always has been and should continue to be good actuarial practice. In fact, if the duration of the liability is not considered, then the assumption might not be a "best-estimate." However, other factors, such as the investment policy for the pension plan and the demographics of the population, must be also considered.

b. Basis for Measurement - Benefit Projections. The Board asked whether the CAS should exclude, permit or require recognition of future period salary increases for measuring the pension obligation. In addition, comments were requested as 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.

Comments: Most respondents recommended exclusion of a future salary increase assumption to be consistent with the PPA minimum required contribution criteria. One commenter opined that:

> Including salary increases would likely increase CAS costs, which would encourage contractors to fund more than the PPA minimum because they would be able to recover the additional

> funding amounts. However, mandatory recognition of salary increases for determining CAS cost would move away from harmonization with PPA.

But another commenter expressed a slightly different view:

> Future salary growth is not an element of a liability driven cost method except to the extent that it affects the benefits accruing in the current year-the "target normal cost." Assumptions regarding salary growth beyond the current year do not affect existing liabilities and should not be part of the assumptions used to determine current cost.

Nearly all respondent industry and professional associations and contractors recommend that CAS be aligned with the PPA to allow recognition of established patterns of collectively bargained benefits. A commenter opined that:

> … under the PPA the recognition of established patterns of collectively bargained benefits is exclusively associated with the determination of maximum deductible limits and is consistent with the recognition of future period salary increases for this purpose. However, if the CAS rules fail to recognize established patterns of collectively bargained benefits, situations could arise in which otherwise assignable costs might be restricted.

However, another commenter offered a contrary view stating "we believe that CAS should continue to follow the IRS funding rules that allow companies to reflect negotiated benefit increases in their liabilities, but not allow patterns of increases to be reflected in the liabilities."

Response: The Board believes that the measurement of the actuarial accrued liability and normal cost should continue to permit recognition of expected future salary increases. Such recognition is consistent with a long-term, going-concern basis for the liability measurement. Since the benefit increases attributable to the salary increases are part of the long-term cost of the pension plan, including a salary increase assumption helps to ensure that the assigned cost adequately funds the long-term liability. Anticipating future salary growth may also avoid sharp pension cost increases as the average age of the plan population increases with the march of the "baby-boomers" towards retirement..

One of the major shortcomings of the PPA minimum required contribution is that it only provides funding of the current settlement liability for accrued benefit. Congress increased the tax-deductible limit, which

includes salary projections, to allow plan sponsors to fund their plans beyond the minimum settlement liability level.

Under the PPA, a major improvement towards adequate funding is the ability to recognize established patterns of increases in flat benefits provided through a collectively bargained pension plan. A major contributor towards the historical underfunding of union pension plans has been the inability to anticipate and fund towards expected future increases. As with the recognition of salary increases, full and adequate funding dictates that increases in benefits be recognized as soon as such increases can be reasonably foreseen. Therefore this draft proposed rule permits an assumption regarding benefit increases for collectively bargained plans to be used to measure the plan's cost. In order to coordinate with ERISA's recognition of such future benefit increases, and to enhance visibility, the Board is proposing to accept the ERISA criteria and assessment of the best-estimate assumption regarding these increases.

c. Basis for Measurement - Mortality Table. For measuring the pension obligation, commenters were asked if the CAS should 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.

Comments: Generally, respondents recommended that CAS allow the use of any mortality table that is acceptable under PPA. One commenter went on to explain that:

> Most plan valuations are based on standardized mortality tables, except for very large plans with credible experience. The PPA recognizes this by providing a "safe harbor" mortality table that all companies can use, but allowing larger plans to use a mortality table based on their own experience. For consistency and simplification, the Board should allow companies to use the same mortality table that is used for determining minimum required contributions under the PPA.

Response: The mortality tables mandated by the PPA are based on the RP2000 mortality which reflects the most recent mortality experience and trends, and can therefore be considered to comply with the long-term, "best-estimate" criteria for assumptions. In fact, the generational projection of the PPA basic mortality table and the annual updates to the PPA static mortality table will help ensure that the mortality assumption remains a "best-estimate." The Board believes that no change to CAS 412 and 413 is necessary.

9. "At-Risk" pension plans. The Board asked to what extent, if any, should the CAS be revised to include special funding rules for "at risk" plans.

<u>Comments</u>: Most industry and professional associations and contractors recommended that CAS recognize "at risk" pension plans pursuant to criterion provided in the PPA including their related, minimum funding requirements. One commenter opined, "we believe that harmonization should include recognition of the PPA funding requirements for 'at risk' plans. The determination of whether or not a plan is 'at risk' should be based on the PPA requirements. In other words there should not be some type of special criteria under CAS in order to determine if a plan is 'at risk.'"

Another commenter suggested that:

> "At risk" provisions could cause costs to spike up temporarily. Ongoing CAS costs should have additional stability if "at risk" provisions are not reflected. In lieu of incorporating "at risk" provisions for ongoing CAS costs, the Board should consider including a cost element that would limit the level of Prepayment Credits resulting from minimum required contributions in excess of CAS costs. For example, the components of the annual CAS assignable cost would be (a) Normal Cost, (b) the 7 year amortization of the unfunded target liability, and (c) a 7 year amortization of any Prepayment Credit greater than 1% of assets (or some other threshold). Such an additional cost component would address the increased difference in funding requirements over CAS assignable costs for 'at risk' plans.

<u>Response</u>: While the Board believes that it would be unusual for Government contractors to be deemed "at risk," the effect of the "at risk" provisions on the PPA minimum required contribution is significantly mitigated by the PPA's phase-in rules for the "at risk" contribution. The best-estimate of long-term assumptions for an "at risk" plan might appropriately be more conservative, if that status is expected to persist for an extended period of time.

10. Amortization periods. The SDP asked whether, for contract cost measurement, the Board should (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 seven year period consistent with the PPA minimum required contribution computation, or (iv) adopt some other amortization period(s).

Comments: The majority recommendation from industry and professional associations and contractors is that the adoption of a seven year amortization period would be consistent with the PPA and preferred for simplicity, uniformity, and consistency among contractors. However, one commenter opined:

> … a longer amortization period than PPA permits is an option that the Board should consider for mitigating volatility for CAS cost. If the CAS cost is measured using the same definitions of liabilities, normal cost, and assets that appear in the PPA, then a strong argument could be made that harmonization has been achieved. A difference in amortization periods applied after the "harmonized" basis may address volatility concerns for CAS costs without preventing achievement of harmonization.

This commenter further observed that:

> A notable difference in the pension calculations for ERISA prior to PPA and for CAS is the length of amortization periods used, especially for experience gains and losses. ERISA amortized actuarial gains and losses over 5 years; CAS, 15 years. Differences in amortization periods are among the least disruptive to the process of the actuarial calculations while providing greater smoothing of volatilities for CAS purposes. We recommend that the Board consider longer amortization periods for the unfunded liabilities and actuarial gains and losses resulting from the PPA calculations as an option to mitigate the volatility introduced in these two areas. We believe that extending the amortization periods would still allow the Board to achieve a harmonized basis in that the CAS cost would be measured using the same definitions of liabilities, normal cost, and assets.

Response: The Board reviewed the recent trends in financial reporting and ERISA funding requirements. The Board also examined the effect of shorter amortization periods on cost volatility. Accordingly, the Board believes that the current 15-year amortization period for gains and losses delays recognition of the gain or loss too far beyond the period in which the gain or loss emerged. The Board continues to believe that for contract costing purposes 10 years is the shortest appropriate period for amortization of the various portions of the unfunded actuarial liability. The Board found little improvement in the assignment of costs by shortening the amortization period to 7 years, and is concerned that a 7-year amortization period may introduce unnecessary volatility.

This draft proposed rule retains the existing permissible 10 to 30 year range for amortization periods for improved or new benefits, changes in actuarial cost methods or changes in actuarial assumptions. Retaining this range allows flexibility for contractors when setting their goals for pension funding and establishing cost accounting practices. The draft proposed rule accelerates the recognition of gains and losses by shortening the amortization period from 15 to 10 years.

The draft proposed rule also retains the requirement to separately identify and establish amortization periods for each portion of unfunded actuarial liability. Disclosure of the unfunded actuarial liability by source enhances the visibility needed to assess the appropriateness of the various actuarial assumptions.

11. Assignable Cost Limitation. The public was asked to comment whether the CAS assignable cost limitation provision should be revised as part of the efforts to harmonize the CAS with the PPA.

Comments: Most industry and professional associations and contractors support retaining the CAS assignable cost limitation (ACL) with the proviso that, after harmonizing with the PPA, the ACL should never be less than the minimum required contribution nor greater than the maximum deductible contribution.

One commenter suggested

> The Board should adopt a symmetrical method of cost recognition. The assignable cost for a period should be defined as the target normal cost plus a 7 year amortization of the difference between the target liability and the plan assets (adjusted for prepayments). If a plan has a surplus, the assignable cost should be the target normal cost less a 7 year amortization of the surplus. The assignable cost will be zero only if the 7 year amortization of surplus exceeds the target normal cost. This symmetric treatment of deficits and surplus will greatly mitigate volatility of assignable cost.

Response: The Board has reviewed the effect of the assignable cost limitation on cost assignment, especially the effect on predictability. Government agencies and contractors have both found that the abrupt and substantive change in pension cost as a plan goes above or below the current assignable cost limitation gives an unintended windfall to one party or another with respect to fixed price contracts. These abrupt and substantive changes also wreak havoc on program budgeting for flexibly-priced contracts. Currently, once assets equal or exceed the actuarial accrued liability and normal cost, the

pension costs drop to zero and the Government's recovery of the surplus can be indefinitely delayed. When assets are lower than the liability and normal cost, the reverse occurs and the contract may never be able to recover substantial incurred pension costs that were never priced.

The draft proposed rule revises the assignable cost limitation to allow the accumulation of a reasonable asset surplus that can serve as a reserve against sudden and unexpected decreases in asset values. Normally, actuarial gains arising from the causes of the surplus will reduce the surplus in an orderly fashion through the normal amortization process. If the net amortization installment is a credit that exceeds the normal cost, the assigned cost will continue to be limited to the zero dollar floor and the "negative" pension cost will be reassigned as an assignable cost credit. In that case all amortizations will continue unabated and thereby reduce volatility.

The revised assignable cost limitation is based on 125% of the actuarial accrued liability, measured without regard to the minimum actuarial liability, plus the normal cost for the period. The Board believes that an asset surplus that is more than 125% of the liability is excessive. In any period that the revised assignable cost limitation applies, the pension cost will be limited and all existing amortization bases will be deemed fully amortized.

The Board seeks additional comments whether public commenters believe that volatility might be better controlled if amortization bases always continue unabated, even if the assets exceed the 125% threshold?

12. Negative pension costs. In the SDP, comments were sought regarding the extent to which the CAS should be revised to address negative pension costs in the context of cost volatility.

Comments: The majority of industry and professional associations and contractors rejected the recommendation to modify CAS to accommodate the concept of negative pension costs. It was noted that the ERISA does not allow for negative pension costs so in the interest of harmonization the concept should be rejected. Two industry associations commented that:

> We recommended CAS not be revised to allow for negative pension costs. In order for pension costs calculated in accordance with the CAS to be claimed, the 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 pension costs twice, once through required contributions into the pension trust and then again as reduced reimbursements on Government contracts.

Another commenter observed that "pension cost would be negative if the 7-year amortization of a surplus exceeded the target normal cost. Pension costs must be funded to be reimbursable. Since a negative pension cost cannot be funded, it should be treated as zero. Pension cost would remain zero until the target normal cost exceeds the 7-year amortization of the surplus, or if the surplus changes to a deficit."

Response: This draft proposed rule retains the zero dollar floor for the assigned pension cost. The primary purpose of the pension harmonization is to provide better coordination between the assigned contract cost and the minimum funding requirement of ERISA. Revising the CAS such that negative pension costs would be assigned and allocated to contracts as credits, but which the contractor is prohibited from removing from the pension fund, would move the CAS away from harmonization.

The lack of recognition of negative costs may in some situations indefinitely delay the Government's recovery of an excessive asset surplus. However, if the plan's benefits are curtailed, the pension plan terminated, or the segment is closed, then any asset surplus will be recognized and adjusted in accordance with 9904.413-50(c)(12). On the other hand, the proposed revision to the assignable cost limitation allows the accumulation of a small asset surplus that can provide an appropriate buffer against adverse experience and is supportive of the PPA's intent.

13. Market Value of Assets and Accrued Contributions. The SDP inquired if an interest adjustment should be made for contributions made after the end of the plan year based on the actual rate of return on investments as now required by the PPA. Previously ERISA had "deemed" such delayed contributions to have been made on the last day of the plan year.

Comments: The majority of respondents recommend that interest adjustments for contributions be based upon the actual date of deposit as required by the PPA.

Response: The Board agrees. The draft proposed rule requires that contributions made after the valuation date be discounted from the date of deposit back to the valuation date at the long-term interest rate assumption used for CAS 412 and 413. However for qualified defined benefit plans, under the proposed rule the present value of contributions recognized for purposes of measuring the market value of assets for ERISA will be accepted for CAS purposes. While this is a departure from the general requirement that the assumed interest rate be based on long-term expectations, this revision promotes harmonization and visibility by allowing the same market value of assets to be used for both CAS and ERISA purposes.

14. Actuarial value of assets. The public was asked whether the Board should restrict the corridor of acceptable actuarial asset values to the range specified in the PPA (90% to 110% of the market value). Comments were requested regarding whether the Board should adopt the PPA's 25-month averaging period for asset smoothing.

Comments: The consensus recommendation from respondents was that the corridor of acceptable asset values should be restricted to the 90% to 110% range specified in the PPA to achieve harmonization, uniformity, and consistency among contractors. However, some contractors opined that the narrower corridor will result in greater annual volatility in the actuarial value of assets and resulting minimum required contribution. One of the commenters suggested that "while adoption of this narrower corridor is more likely to result in more frequent adjustments of assets to market that require amortization, we believe that a longer amortization period than PPA permits is an option that the Board should consider for mitigating any undesirable effects for CAS cost."

In addition, most respondents believed that the Board should adopt the 25-month averaging period for asset smoothing stipulated in the PPA to achieve harmonization and consistency among contractors. However, some contractors opined that decreasing the smoothing period from 60 months to 25 months will contribute to greater annual volatility in the actuarial value of assets and resulting minimum PPA required contribution. One commenter noted that:

> CAS currently allows the prior ERISA smoothing techniques. Since forward pricing and contract bids often extend well beyond two years, continuing to allow for the greater smoothing of assets under CAS would provide for more predictable costs and less year-to-year volatility, and thus would provide for a better basis to forecast pension costs. Ultimately, the assets are smoothed toward the same market value so this is not a long-term cost difference. However, this may be an area where a difference between CAS and the new PPA rules is advisable to keep, since it would provide for better forward pricing and more predictable contract costs.

An alternative approach some companies are exploring is to align their investment strategy with the corporate bond discount rate used by the PPA and GAAP to measure pension costs. A commenter noted that it, "like many companies, is looking at a Liability Driven Investment (LDI) strategy to further mitigate the impact of the PPA changes. Such a strategy is easier to implement and easier to manage if

we are working with similar rules and similar assumptions for both the PPA required contribution calculations and the CAS reimbursement requirements."

Response: The Board believes that no revision of the current 80% to 120% corridor is necessary to achieve harmonization. Maintaining the current 80% to 120% corridor around the market value of plan assets provides flexibility for contractors to elect asset smoothing techniques that might inhibit contract cost volatility between periods. The Board observes that contractors who do hold their actuarial value of assets to a 90% to 110% corridor would remain compliant with the CAS.

Similarly, the Board believes that no revision of the asset valuation method is needed for harmonization. The Board notes the CAS does not specify the use of a 60-month amortization period for smoothing, the 60-month smoothing technique has been historically used because it was compliant with pre-PPA ERISA and the CAS. Contractors are reminded that the CAS will continue to require that any asset smoothing method provide "equivalent recognition of appreciation and depreciation of the market value of the assets."

15. Potential cost volatility between periods. The SDP inquired to what extent, if any, whether adoption of some or all of the PPA provisions would impact the volatility of cost projections. Comments were also requested concerning ways to mitigate the effects of the potential volatility in contract costs.

Comments: Respondents identified several provisions of the PPA that may introduce volatility including: (1) use of a two year average corporate bond interest rate to discount future pension liabilities introduces securities market fluctuations not currently present in CAS with its single discount rate; (2) reduction in the asset valuation corridor from the CAS 80% - 120% range to the PPA 90% - 110% range will likely increase frequency of asset adjustments to market value; (3) reduction in the smoothing period from 60 months per CAS to 25 months per the PPA; and (4) reduction of the amortization period of any unfunded liability from the CAS 10- to 30-year range to the PPA range of 7 years.

Respondents typically expressed uncertainty in quantifying the effect of changing CAS to PPA requirements. Many supported mitigating the effects of volatility through use of transitional rules and provisions for smoothing after identifying the range of potential CAS changes and assessing their respective cost impacts. One commenter suggested that limiting the change in the assignable cost from one period to the next by a factor based on the previous year's normal cost or target liability could be used to reduce volatility.

Response: As discussed above, the Board believes the draft proposed rule sufficiently revises the measurement and assignment provisions of CAS 412 and 413 to achieve harmonization with the PPA minimum required contribution while limiting volatility. To recap, the Board proposes to: (1) maintain the current criteria that assets may be smoothed by any generally acceptable asset valuation method providing that appreciation and depreciation are equally treated, (2) maintain the current 80% to 120% of market value of asset corridor limit on the actuarial value of assets, (3) revise the assignable cost limitation to allow a reasonable asset surplus, (4) reduce the amortization period for gains and losses from 15 to 10 years, and (5) retain the current CAS amortization range of 10 to 30 years for all other portions of the unfunded actuarial liability or actuarial surplus.

The Board welcomed the many thoughtful suggestions made by the commenters. The Board did consider several other methods for dampening volatility, including a limit on the change in cost between periods and a smoothed reconciliation method. However, each alternative considered would have increased the complexity of the cost computation without significantly improving cost stability between periods.

The proposed changes to CAS 412 and 413 provide flexibility for contractors concerning the long-term funding of its pension obligation, and are generally more lenient than the criteria for determining the minimum required contribution, or, in the case of 7-year or 10-year amortization, provide reasonably similar assignment of costs. The Board further believes that these criteria not only provide adequate harmonization, but have been and will continue to be sufficiently robust to accommodate future changes to ERISA.

16. Contractor Cash Flow Concerns. The Board sought comments to what extent, if any, whether the measurement and assignment provisions of CAS 412 and 413 should be revised to address contractor cash flow concerns. Another question raised in the SDP regarded the extent to which the current prepayment provisions mitigate contractor cash flow concerns. As a follow-up question, the public was asked to what extent, if any, whether the prepayment credit provision should be revised to address the issue of potential negative cash flow.

Comments: Industry and professional associations and contractors overwhelmingly identified the potential mismatch in cash flows between the PPA and CAS as a crucial issue for harmonization. One of the commenters asserted:

> It is important for the CAS board to recognize the serious dilemma presented by PPA for the defense industry and the US Government. … the defense industry as a whole will face significant cash flow problems should the CAS not be fully harmonized with PPA including its minimum pension funding requirements. Absent full harmonization, these negative cash impacts could seriously harm industry and adversely affect a company's decision to continue providing pension benefits to employees.

Another commenter stated:

> Unless the costs are assigned to accounting periods in a manner which facilitates recovery coincident with or close to the accounting periods in which the cash contributions are required, harmonization cannot be achieved. Unless department and agency budgets are adjusted to take into account the large increases in pension costs that are anticipated to occur under harmonization, serious programmatic effects in the future could develop if program dollars need to be diverted to reimbursement of pension costs.

Two of the industry associations opined that "if a contractor's cash flow is impacted severely enough, in order to remain viable a contractor may have no other choice but to terminate its defined benefit pension plan, settle up all benefit obligations, and claim the resulting cost."

The consensus of industry and professional associations and contractors is that the current CAS prepayment provisions are inadequate relief from negative cash flow that will be exacerbated by the PPA. The industry associations explained "it is important to note that the protection provided to the contractor by the prepayment credit feature is only measured by the timeliness of the cost recovery. We believe that prepayment credits should be retained in CAS, but again, this mechanism alone would not satisfy the requirement of harmonization."

An actuarial consulting firm noted, "While Prepayment Credits take into account the funding contributions in excess of currently assignable costs so that such excess contributions could be reimbursed in the future, the excess contributions deferred into future years may not have eligible contracts to charge the costs against."

The consensus of industry and professional associations and contractors is that there is no need for revisions to the current prepayment credit provisions should harmonization with the PPA be maximized.

As one commenter stated, "If the assignable cost is not less than the PPA minimum required contribution, there is no need to revise the prepayment credit provisions. A contractor that chooses to make a prepayment (perhaps for cash flow or tax planning reasons) would be able to be reimbursed in a subsequent year under the current provisions."

However, respondents did identify the need to recover existing prepayment credits within a reasonable period of time after CAS harmonization. One commenter opined "at a minimum, the CAS would need to include an amortization of prepayment credits as an independent and additional component in determining assignable costs to produce any meaningful mitigation of contractor's cash flow concerns. Such an independent component would require assignability even if the plan's regular assignable cost limit would produce a zero assignable cost under the 'regular' cost determination." Another commenter noted, "even if CAS reflects the assumptions, actuarial cost method, and amortization period under the PPA, Prepayment Credits could exist indefinitely unless an additional cost element to address the level of Prepayment Credits is incorporated in CAS. This has occurred under pre-PPA rules even though CAS mirrored the minimum funding rules, but did not set the CAS cost equal to the minimum funding requirement."

The majority of respondent industry and professional associations, contractors, and government recommend use of the actual return on plan assets to adjust the accumulated value of prepayment credits. This approach supports harmonization and eliminates variances stemming from differences in rates.

A comment from a government agency provided an example illustrating inequities with the PPA from use of the CAS valuation rate and noted that:

> The contractor does not distinguish prepayment credits from other assets when calculating gains or losses and allocating them to segments. All plan assets earn the same rate of return. CAS requires prepayment credits to be adjusted for interest at the valuation rate; therefore, the difference between the valuation rate and the actual rate of return generates a gain or loss attributable to the prepayment credits. …. While this benefits the Government when gains occur, Government segments will share in the losses as well. The Government should not share in this risk because it has no ownership interest in the prepayment credit assets.

Response: One of the primary concerns expressed was the financial impact of prolonged or indefinite delays to including the full amount of the ERISA minimum required contribution in contract costing for

pensions. The Board examined various means of pension harmonization. Unless the assigned contract cost was set equal to the PPA minimum required contribution, prepayment credits could still be created by minimum required contributions. Furthermore, in the absence of regulatory change, prepayments that have been accumulated during periods prior to harmonization are likely to persist indefinitely. Therefore, the Board proposes to revise the CAS to provide a means of recognizing the excess, if any, of an ERISA minimum required contribution over the assigned pension cost for the period.

To accomplish this, the draft proposed rule makes a distinction between mandatory and voluntary prepayments. Mandatory prepayments are defined as the excess of the minimum required funding amount over the assigned pension cost for a period, where the minimum required funding amount is the PPA minimum required contribution reduced by any ERISA carry-over or prefunding balances. The carry-over and prefunding balances are not assigned to periods by the PPA. Instead, they are deducted from the minimum required contribution based on a unilateral decision by the contractor and influenced by the contractor's unique circumstances.

Once identified and measured, mandatory prepayment credits are separately identified in a mandatory prepayment account and amortized in level installments over a 5-year period beginning with the next cost accounting period. The amortization of the mandatory prepayment emulates the amortization of the unfunded actuarial accrued liability and includes an interest equivalent based on the assumed long-term interest assumption. A mandatory prepayment charge is measured by this amortization, and to the degree it is not applied towards the funding of the current assigned cost, it becomes a second component of allocable cost in addition to the funded portion of the assigned pension cost. The unapplied portion of the mandatory prepayment charge is then allocated to intermediate and final cost objectives for recognition in contract costing.

Voluntary prepayments are created by any contribution made in excess of funded portion of the assigned cost. These are voluntary contributions that the contractor has elected to make based on its own financial management decisions regarding the pension plan. The draft proposed rule specifies that voluntary prepayment credits must be applied towards funding the assigned cost before any contributions in excess of the minimum required contribution is applied. Because the contractor has chosen to deposit these excess contribution into the pension fund voluntarily, the draft proposed rule requires that these prepayments be carried forward using the actual rate of return on investments. This is consistent with the PPA's treatment of carry-over and prefunding balances and accords the same investment earnings to assets attributable to required and voluntary contributions.

Under the transition rule (discussed below), the contractor must identify which portion of the accumulated value of prior prepayment credits is attributable to funding minimum required contributions in excess of the assigned cost. Once so identified, this “legacy” mandatory prepayment credit may be amortized in accordance with the transition rule and allocated to cost objectives.

17. Recognition of PPA provisions when measuring a segment closing adjustment. The Board asked to what extent, if any, whether adoption of some or all of the PPA provisions would affect the measurement of a segment closing adjustment in accordance with CAS 413.50(c)(12).

Comments: The majority of respondent industry and professional associations and contractors believe that, in order to foster CAS harmonization with the PPA, the PPA funding target calculation should be the basis of measurement for any segment closing adjustment. One commenter observed that if the Board adopts the liability driven method of PPA and comparable assumptions, then the need for most settlement adjustments would be eliminated. Two commenters favored retaining the CAS concepts 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. They opined that these additional provisions address specific situations found in Government contracting that are beyond the scope of PPA and the requirement of harmonization.

However, several commenters distinguished treatment of a plan termination from a plan curtailment or segment closing. One commenter stated that “if the contractor is terminating the plan, and settling plan liabilities or turning over the liabilities to the PBGC, then the actual termination liability should be used in segment closing adjustments (consistent with current CAS) and roughly equal to the PPA ‘at-risk’ liability provisions.”

Response: As with the measurement of the actuarial accrued liability for on-going pension costs, the draft proposed rule makes the actuarial accrued liability used to measure a segment closing adjustment subject to the minimum actuarial liability for purposes of 9904.413-50(c)(12)(i). Such treatment provides consistency between the measurement of on-going pension costs and computation of a 9904.413-50(c)(12) adjustment. The proposed rule preserves the recognition of an actual annuity purchase, lump sum settlement payments or amount contributed to indemnify the PGBC as the actuarial accrued liability for measuring the 9904.413-50(c)(12) adjustment.

18. ERISA mandated cessation of benefit accruals. The Board inquired whether 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.

Comments: Several comments from actuaries suggested elimination of the present CAS 413 plan curtailment as applied to the PPA "at-risk" plans, since neither the plan nor the contracting relationship has been terminated. They suggest that annual CAS pension costs could continue to be measured, assigned, and allocated for curtailed plans. Directly addressing the question one commenter opined that "the PPA mandatory cessation of benefit accruals for an 'at risk' plan should not be subjected to the curtailment procedures under CAS 412 and 413." Another commenter explained that:

> Unless CAS 413-50(c)(12) is amended, we believe that cessation of benefit accruals resulting from a funding target attainment percentage of less than 60% could be construed as requiring a segment-closing adjustment. This would seem inconsistent with the purpose of these provisions since accruals would normally automatically resume when the funding percentage equals or exceeds 60%. In fact, the CAS 413 adjustment provides a ready mechanism for ensuring this level is achieved as the adjustment mechanism represents a definite source of cash that could be used to fund the plan over and above what minimum funding might require. In other words, if an "at risk" plan status triggers the segment closing adjustment, the Government's share of the adjustment would provide the contractor with a source of cash to contribute to the plan to bring it out of the "at-risk" status. While this would benefit the plan, we do not think that it reflects the intent of the CAS 413 adjustment. Accordingly, we believe that CAS 413 should be revised to exclude treating curtailment of benefits solely due to the "at risk" rules in the same manner as other plan curtailments.

Response: This draft proposal exempts any curtailment of benefit accrual required by ERISA from immediate adjustment under CAS 413-50(c)(12). The draft proposed rule also addresses recognition of the accruals during the period of curtailment dependent upon whether or not the written plan provides for retroactive restoration of the accruals. Voluntary benefit curtailments (plan freezes) continue to be subject to adjustment in accordance with 9904.413.50(c)(12). It should be noted that the mere closing of pension participation for new employees does not constitute a benefit curtailment.

19. Transition. The SDP did not directly seek comments on potential transition issues, but the Board received several comments regarding transition provisions.

Comments: One commenter contributed an additional recommendation that, "any accounting changes contractors are required to make in response to the Cost Accounting Standards Pension Harmonization Rules should be treated as a 'required change' to the contractor's established cost accounting practices subject to a request for equitable adjustment under CAS 9903.201-6(a), irrespective of whether such change is permissive or required under the harmonization rules."

One commenter suggested that, although not now required to do so, the Cost Accounting Standards Board might take the opportunity to make other changes to CAS 412 and 413. This commenter identified a need for clarification of transitional issues which pertain to prepayment credits before and after PPA, the treatment of PPA minimum funding costs allocated to fixed-price contracts, and segment closings after CAS harmonization rules are adopted.

Response: The changes to CAS 412 and 413 are proposed to be phased-in over a period of years that roughly matches the typical contracting cycle. The proposed phase-in allows the cost impact of this draft proposed rule to be gradually recognized in the pricing of CAS-Covered and FAR contracts alike. Any increase in the actuarial accrued liability due to the minimum actuarial liability will be phased-in over 5 years at 20% per year. The phase-in of the minimum actuarial liability also applies to segment closing adjustments. The amortization period for actuarial gains and losses will be reduced by 1 year annually from 14 to 10 years. Likewise, the amortization period for mandatory prepayment charges will be reduced by 2 years annually from 12 to 5 years, *i.e.*, use a 12-year period for amortization that begins in the first year, a 10-year period for amortization beginning the second year, an 8-year period for any amortization beginning in the third year, next a 6-year period in the fourth year, then a 5-year period for all amortization beginning after the fourth year.

The Board appreciates the concerns expressed on transitional issues related to prepayment credits created before and after the CAS is amended, and the effect on forward pricing for both contractors and the procuring agencies. These issues are specifically addressed by other public comments.

While changes required by this draft proposed rule would be mandatory changes, the Board emphasizes that changes to cost accounting practices, such as, but not limited, to a change in the actuarial cost method, change in the basis for setting assumptions or a change in actuarial asset method, will continue to be voluntary or unilateral changes to the contractor's cost accounting practice.

20. Record Keeping. In light of the changes to the PPA, the Board wanted to know whether specific requirements in CAS 412 and 413 should be considered regarding the records required to support the contractor's proposed and/or claimed pension cost.

Comments: Respondents typically believe any required or useful record-keeping requirements under the PPA should be adopted by the Board for harmonization with CAS. One of the actuarial consulting firms commented that "our CAS reports will continue to provide details that support the development of the CAS assignable costs, liabilities, assets and Prepayment Credits. We are not aware of any specific PPA provisions that would necessitate records to support the contractor's proposed and/or claimed pension cost other than documentation currently provided by contractors."

Response: Because the Board did not receive any comment for record keeping criteria, this subject is not addressed in this draft proposed rule. Documentation and data support for the computation of pension costs remains subject to CAS administration and audit rules and guidance.

21. Surveys and Modeling Data. In the SDP the Board announced that it 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.

Comments: Preliminary research results conducted by Watson Wyatt and Company and Mercer Human Resource Consulting were provided in their written responses. Some contractors offered to share results of their cost modeling, but suggested the Board first identify the range of possible changes to CAS to reduce the number of models. Several respondents encouraged the Board to consider the following circumstances: (1) different funding levels (over/under), (2) existing assignable cost deficits, (3) existing prepayment credits, and (4) "at risk" plans. Two of the industry associations identified general studies from actuarial consulting firms as useful resources, and suggested data modeling as an analytical tool. Another industry association recommended that the Board tentatively resolve significant harmonization issues to allow industry to selectively model the consequences during an extended comment period of at least 120 days.

Response: Many commenters expressed an interest in modeling the effects of harmonization revisions to CAS 412 and 413, but wanted the Board to define the parameters of such harmonization revisions. The Board is very interested in the results of any modeling or surveys that commenters may be willing to submit.

The Board cautions that all public comments, including any modeling or survey data, will be made available to the public in their entirety after the close of the public comment period.

D. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96-511, does not apply to this draft proposed rule, because this rule imposes no paperwork burden on offerors, affected contractors and subcontractors, or members of the public which requires the approval of OMB under 44 U.S.C. 3501, et seq. The records required by this draft proposed rule are those normally maintained by contractors who claim reimbursement of post-retirement benefit costs under government contracts.

E. Executive Order 12866 and the Regulatory Flexibility Act

Because most contractors must measure and report their post-retirement benefit liabilities and expenses in order to comply with the requirements of SFAS 106 for financial accounting purposes, the economic impact of this draft proposed rule on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this draft proposed rule will not result in the promulgation of an "economically significant rule" under the provisions of Executive Order 12866, and that a regulatory impact analysis will not be required. Furthermore, this draft proposed rule does not have a significant effect on a substantial number of small entities because small businesses are exempt from the application of the Cost Accounting Standards. Therefore, this draft proposed rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980.

F. Public Comments to Advanced Notice of Proposed Rulemaking

Interested persons are invited to participate by providing input with respect to harmonization of CAS 412 and 413 with the PPA. All comments must be in writing, and submitted via facsimile or by e-mail as instructed in the ADDRESSES section.

To comply with the Congressional mandate in Section 106 of the PPA (Section 106), the Board must complete its statutorily required 4-step promulgation process no later than January 1, 2010. Therefore,

the Board reaffirms its determination that this case must be limited to pension harmonization issues. As always, the public is invited to submit comments on other issues regarding contract cost accounting for pension cost that respondents believe the Board should consider. However, comments unrelated to pension harmonization will be separately considered by the Board in determining whether to open a separate case on pension costs in the future. The staff continues to be especially appreciative of comments and suggestions that attempt to consider the concerns of all parties to the contracting process.

The Board will monitor the comments received from the ANPRM and schedule a public meeting if they believe one is warranted, based on the comments.

G. List of Subjects in 48 CFR 9904

Government Procurement, Cost Accounting Standards.

Paul A. Denett
Chairperson, Cost Accounting Standards Board

This is a draft of a proposed rule to amend part 9904 as follows: PART 9904--COST ACCOUNTING STANDARDS

1. The authority citation for Part 9904 continues to read as follows: Authority: Public Law 100-679, 102 Stat 4056, 41 U.S.C. 422.

9904.412 Cost accounting standard for composition and measurement of pension cost.

* * * * *

9904.412-30 Definitions.

(a) * * *

(1) * * *

2. Section 9904.412-30(a) is amended by revising paragraph (9) to read:

(9) Assignable cost limitation means the excess, if any, of 125 percent of the actuarial accrued liability, without regard to the minimum actuarial liability, plus the current normal cost over the actuarial value of the assets of the pension plan.

3. Section 9904.412-30(a) is amended by deleting paragraph (23).

4. Section 9904.412-30(a) is amended by renumbering paragraphs (24) through (25) as (26) through (27).

5. Section 9904.412-30(a) is amended by renumbering paragraphs (16) through (22) as (19) through (25).

6. Section 9904.412-30(a) is amended by renumbering paragraph (15) as paragraph (16).

7. Section 9904.412-30(a) is amended by inserting new paragraph (15) as follows:

(15) Mandatory prepayment credit means the amount of the minimum required funding in excess of the pension cost assigned to a cost accounting period. Mandatory prepayment charge means the minimum amount of a mandatory prepayment credit that is applied towards funding of the assigned pension cost or separately allocated to cost objectives. Applied mandatory prepayment means the mandatory prepayment credits used to fund the assigned pension cost. Mandatory prepayment account means the value, as of the measurement date, of the mandatory prepayment credits adjusted for interest at the long-term assumed rate of interest and decreased by applied mandatory prepayments and separately allocated mandatory prepayment charges during the current period.

8. Section 9904.412-30(a) is amended by inserting paragraphs (17) and (18) as follows:

(17) Minimum Actuarial Liability means the actuarial accrued liability measured under the accrued benefit cost method and using an interest rate assumption as described in 9904.412-50(b)(3)(ii). Minimum Normal Cost means the normal cost measured under the accrued benefit cost method on the same basis as the minimum actuarial liability.

(18) Minimum Required Funding means the contribution amount for a period that is necessary to satisfy the minimum funding requirements for a qualified defined-benefit pension plan determined

in accordance with ERISA. The contribution amount shall be reduced by any pre-funding credits (e.g., credit balances, carry-over balances, prefunding balances), except such credit balances that ERISA requires to be waived.

9. Section 9904.412-30(a) is amended by inserting paragraph (28) as follows:

(28) Voluntary prepayment credit means the amount of the minimum required funding in excess of the pension cost assigned to a cost accounting period. Applied voluntary prepayment means the voluntary prepayment credits used to fund the assigned pension cost. Voluntary prepayment account means the value, as of the measurement date, of the voluntary prepayment credits adjusted for interest at the actual investment rate of return and decreased by applied voluntary prepayments during the current period.

9904.412-40 Fundamental requirement.

(a) * * *

(b) Measurement of pension cost.

(1) * * *

10. Section 9904.412-40(b) is amended by adding paragraph (3).

(3) "CAS Harmonization Rule":

(i) In any period that the minimum actuarial liability exceeds the actuarial accrued liability, the contractor shall adjust the actuarial accrued liability and normal cost used to compute the pension cost for the period by:

(A) Measuring a liability adjustment amount equal to the excess of the minimum actuarial liability over the actuarial accrued liability for the period. The adjusted actuarial liability for the period shall be the actuarial accrued liability plus the liability adjustment amount. The unfunded actuarial liability, or asset surplus, shall

be measured based on the adjusted actuarial liability; and

(B) Measuring a normal cost adjustment amount equal to the minimum normal cost less the normal cost for the period. The adjusted normal cost for the period shall be the normal cost plus the normal cost adjustment amount. The assigned pension cost for the period shall be measured based on the adjusted normal cost.

(ii) For purposes of measuring the minimum actuarial liability and minimum normal cost only, the interest assumption shall reflect the contractor's best estimate of rates at which the pension benefits could effectively be settled based on the rates of return on high-quality fixed-income investments of similar duration to the pension benefits. All other actuarial assumptions used to measure the minimum actuarial liability and minimum normal cost shall be the same as the assumptions used elsewhere in this Standard.

(iii) In any period that the assigned pension cost is less than the amount of the minimum required funding, the contractor shall measure and assign such excess as a mandatory prepayment credit in accordance with paragraph 9904.412-40(d) and paragraphs 9904.412-50(a)(4) and (c)(1). Conversely, in any period that the assigned pension cost is greater than the minimum required funding, the contractor shall measure and assign an adjustment for a mandatory prepayment charge in accordance with the same paragraphs.

(c) * * *

11. Section 9904.412-40(d) is amended to read as follows:

(d) Allocation of pension cost. Pension costs assigned to a cost accounting period are allocable to intermediate and final cost objectives only if they meet the requirements for allocation in 9904.412-50(d). Pension costs not meeting these requirements may not be reassigned to any future cost accounting period. For qualified defined benefit plans, the excess, if any, of the mandatory prepayment charge over the applied mandatory prepayment amount shall be separately allocated to intermediate and final cost objectives in addition to the allocable portion of the assigned pension cost.

9904.412-50 Techniques for application.

(a) Components of pension cost.

(1) * * *

12. Section 9904.412-50(a) is amended by revising paragraph (2) to read:

(2) Except as provided in 9904.412-50(d)(2), any portion of unfunded actuarial liability attributable to either (i) pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions or (ii) pension costs assigned to a cost accounting period that were not funded in that period, shall be separately identified and eliminated from any unfunded actuarial liability being amortized pursuant to paragraph (a)(1) of this subsection. Such portions of unfunded actuarial liability shall be adjusted for interest at the actual rate of investment return. The contractor may elect to fund, and thereby reduce, such portions of unfunded actuarial liability and future interest adjustments thereon. Such funding shall not be recognized for purposes of 9904.412-50(d).

(3) * * *

13. Section 9904.412-50(a) is amended by revising paragraph (4) to read:

(4) Any amount funded in excess of the pension cost assigned to a cost accounting period shall be accounted for as a prepayment credit.

(i) Mandatory Prepayment Credits for qualified defined benefit plans.

(A) The amount of the minimum required funding amount in excess of the assigned pension cost under this Standard shall be accounted for as a mandatory prepayment credit and added to the mandatory prepayment account. In any period that the assigned pension cost exceeds the minimum required funding amount, mandatory prepayments shall be applied towards the funding of such excess, for the purposes of 9904.412-50(d)(1). The applied mandatory prepayment shall be used before any portion of the voluntary prepayment

account or contributions in excess of the minimum required funding amount shall be applied for the purposes of 9904.412-50(d)(1) ;

(B) The value of the mandatory prepayment account shall be adjusted for interest at the assumed long-term rate of interest;

(C) The value of mandatory prepayment account shall be reduced by the greater of the mandatory prepayment charge or the applied mandatory prepayment assigned to the period. Any excess of the applied mandatory prepayment over the mandatory prepayment charge assigned to the period shall be used to reduce the unamortized balances of mandatory prepayment credits in the order in which the prepayments were created; and

(D) Any excess of the mandatory prepayment charge over the applied mandatory prepayment shall be separately identified as the mandatory prepayment adjustment for the period.

(ii) Voluntary Prepayment Credits.

(A) Any other funding in excess of the assigned pension cost shall be accounted for as a voluntary prepayment credit;

(B) The value of the voluntary prepayment account shall be adjusted for interest at the actual investment rate of return until applied towards pension cost in a future accounting period;

(C) The voluntary prepayment account shall be reduced for portions of the voluntary prepayment credits used to fund pension costs assigned to the period or to fund portions of unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2); and

(D) The accumulated value of voluntary prepayments credits shall be applied first to fund the pension cost assigned to the period before contributions made to

the funding agency are recognized for funding requirements of CAS 412.50(d)(1).

(iii) Adjustment to Assets. The values of the mandatory and voluntary prepayment accounts shall be excluded from the market and actuarial values of the assets used to compute pension costs for purposes of this Standard and Cost Accounting Standard 9904.413

(b) Measurement of pension cost.

(1) * * *

14. Section 9904.412-50(b) is amended by revising paragraph (5) to read:

(5) Pension cost shall be based on provisions of existing pension plans. This shall not preclude contractors from making salary projections for plans whose benefits are based on salaries and wages, or from considering improved benefits for plans which provide that such improved benefits must be made. For qualified defined benefit plans that ERISA permits to recognize historical patterns of benefit improvements under a plan covered by a collectively bargained agreement, the contractor may recognize the same benefit improvements.

(6) * * *

(c) Assignment of pension cost.

15. Section 9904.412-50(c) is amended by revising paragraph (1) to read:

(1) Amounts funded in excess of the pension cost computed for a cost accounting period pursuant to the provisions of this Standard shall be accounted for as a prepayment credit and carried forward to future accounting periods in accordance with paragraph 9904.412-50(a)(4).

(i) In any year that a mandatory prepayment credit is created by a minimum required funding amount in excess of the pension cost assigned to the period, the mandatory

prepayment credit shall be assigned as a mandatory prepayment charge in equal annual installments over 5 years beginning with the period following the creation of the credit. Each installment shall consist of an amortized portion of the mandatory prepayment credit plus an interest equivalent, based on the long-term assumed interest rate, on the unamortized portion of such prepayment credit. If the unamortized balance of the prepayment credit is reduced by an applied mandatory prepayment, then the amortization installment shall be recomputed based on the number of remaining periods.

(2) * * *

(i) * * *

(d) Allocation of pension costs. * * *

9904.412-60 Illustrations.

(a) Components of pension cost.

(1) * * *

(b) Measurement of pension cost.

(1) * * *

16. Section 9904.412-60(b) is amended by revising illustrations (2) and (3) to read:

(2) For several years Contractor H has had an unfunded nonqualified pension plan which provides for payments of $200 a month to employees after retirement. The contractor is currently making such payments to several retired employees and recognizes those payments as its pension cost. The contractor paid monthly annuity benefits totaling $24,000 during the current year. During the prior year, Contractor H made lump sum payments to irrevocably settle the benefit liability of several participants with small benefits. The annual installment to amortize these lump sum payments over

fifteen years at the long-term assumed interest rate assumption is $5,000. Since the plan does not meet the criteria set forth in 9904.412-50(c)(3)(ii), pension cost must be accounted for using the pay-as-you-go cost method. Pursuant to 9904.412-50(b)(3), the amount of assignable cost allocable to cost objectives of that period is $29,000, which is the sum of the amount of benefits actually paid in that period ($24,000) plus the second annual installment to amortize the prior year's lump sum settlements ($5,000).

(3) Contractor I has two qualified defined-benefit pension plans that provide for fixed dollar payments to hourly employees. Under the first plan, a collective bargaining agreement negotiated with the employees' labor union provides that pension benefits will increase by specified percentages over the next several years. Because the improved benefits are required to be made, the contractor can consider such increased benefits in computing pension costs for the current cost accounting period in accordance with 9904.412-50(b)(5). With regard to the second plan, the contractor's actuary believes that the contractor will be required to increase the level of benefits by specified percentages over the next several years. In calculating pension costs, the contractor may not assume future benefits greater than that currently required by the plan. However, if ERISA permits the recognition of an established pattern of benefit improvements, 9904.412-50(b)(5) permits the actuary to include the same recognition of expected benefit improvements in computing the pension cost for contract costing purposes.

(c) Assignment of pension cost.

17. Section 9904.412-60(c) is amended by revising Illustrations (1) through (6) to read as follows:

(1) Contractor J maintains a qualified defined-benefit pension plan. The actuarial accrued liability for the plan is $20 million and includes the minimum liability adjustment required by 9904.412-40(b)(3). The actuarial value of the assets of $18 million is subtracted from the actuarial accrued liability of $20 million to determine the total unfunded actuarial liability of $2 million. Pursuant to 9904.412-50(a)(1), Contractor J has identified and is amortizing twelve separate portions of unfunded actuarial liabilities. The sum of the unamortized balances for the twelve separately maintained portions of unfunded actuarial liability equals $1.8 million. In accordance with 9904.412-50(a)(2), the contractor has separately identified, and eliminated from the computation of pension cost, $200,000 attributable to a pension cost assigned to a prior period that was not funded.

The sum of the twelve amortization bases maintained pursuant to 9904.412-50(a)(1) and the amount separately identified under 9904.412-50(a)(2) equals $2 million ($1,800,000 + 200,000). Because the sum of all identified portions of unfunded actuarial liability equals the total unfunded actuarial liability, the plan is in actuarial balance and Contractor J can assign pension cost to the current cost accounting period in accordance with 9904.412-40(c).

(2) Contractor K's pension cost computed for 2016, the current year, is $1.5 million. Because the minimum actuarial liability exceeds the actuarial accrued liability, the actuarial accrued liability and normal cost are increased as required by 9904.412-40(b)(3). This computed cost is based on the components of pension cost described in 9904.412-40(a) and 9904.412-50(a) and is measured in accordance with 9904.412-40(b) and 9904.412-50(b). The current balance of the mandatory prepayment account credits is $100,000 which was excluded from the actuarial value of assets used to measure the assigned pension cost. The pension cost so assigned to the period is greater than the minimum required funding amount and, therefore no mandatory prepayment credit is created in accordance with 9904.412-40(b)(3)(iii). The assignable cost limitation, which is defined at 9904.412-30(a)(9), is $1.3 million. In accordance with the provisions of 9904.412-50(c)(2)(ii)(A), Contractor K's assignable pension cost for 2016 is limited to $1.3 million. In addition, all amounts that were previously being amortized pursuant to 9904.412-50(a)(1) and 9904.413-50(a) are considered fully amortized in accordance with 9904.412-50(c)(2)(ii)(B). The amortization of the $100,000 mandatory prepayment account continues unabated. The following year, 2017, the minimum actuarial liability does not exceed the actuarial accrued liability, and therefore an adjustment to the actuarial accrued liability and normal cost is not required by 9904.412-40(b)(3). Contractor K computes an unfunded actuarial liability of $4 million, based on the actuarial accrued liability. Contractor K has not changed his actuarial assumptions nor amended the provisions of his pension plan. Contractor K has not had any pension costs disallowed or unfunded in prior periods Contractor K must treat the entire $4 million of unfunded actuarial liability as an actuarial loss. The actuarial loss must be amortized over ten years beginning in 2017 in accordance with 9904.412-50(c)(2)(ii)(C) and 9904.413-50(a)(2).

(3) Assume the same facts shown in illustration 9904.412-60(c)(2), except that in 2015, the prior year, Contractor K's assignable pension cost was $800,000, but Contractor K only funded and allocated $600,000. Pursuant to 9904.412-50(a)(2), the $200,000 of unfunded assignable pension cost was separately identified and eliminated from other portions of unfunded actuarial liability.

This portion of unfunded actuarial liability was adjusted for 7.230% interest, which is the actual rate of return on plan assets for 2015, and was brought forward to 2016 in accordance with 9904.412-50(a)(2). Therefore, $214,460 ($200,000 x 1.07230) is excluded from the amount being amortized in 2016. The actual rate of return on plan assets for 2016 is 8.776%. The next year, 2017, Contractor K must eliminate $233,280 ($214,460 x 1.08776) from the $4 million so that only $3,766,720 is treated as an actuarial loss in accordance with 9904.412-50(c)(2)(ii)(C).

(4) Assume, as in 9904.412-60(c)(2), the 2016 pension cost computed for Contractor K's qualified defined-benefit pension plan is $1.5 million and the assignable cost limitation is $1.7 million. However, because of the ERISA limitation on tax-deductible contributions, Contractor K cannot fund more than $1 million, which is the sum of the tax-deductible contribution plus the values of the mandatory and voluntary prepayment accounts, without incurring an excise tax, which 9904.412-50(a)(5) does not permit to be a component of pension cost. In accordance with the provisions of 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is limited to $1 million. The $500,000 ($1.5 million - $1 million) of pension cost not funded is reassigned to the next ten cost accounting periods beginning in 2017 as an assignable cost deficit in accordance with 9904.412-50(a)(1)(vi).

(5) Assume the same facts for Contractor K in 9904.412-60(c)(4), except that the value of the voluntary prepayment account equals $700,000. Therefore, Contractor K must apply $700,000 of voluntary prepayment credits towards the pension cost computed for the period before applying $800,000 of the $1 million contribution in accordance with 9904.412-50(a)(4)(ii)(D). In accordance with the provisions of 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is the full $1.5 million ($700,000 + $800,000) computed for the period. The $200,000 of excess contributions creates a new voluntary prepayment credit of $200,000 ($1 million - $800,000) which is adjusted for $14,460 of interest at the actual rate of return on plan assets and the sum of $214,460 is carried forward until needed in future accounting periods in accordance with 9904.412-50(a)(4)(ii)(B).

(6) Assume the same facts for Contractor K in 9904.412-60(c)(4), except that the 2016 assignable cost limitation is $1.3 million. Pension cost of $1.5 million is computed for the cost accounting period, but the assignable cost is limited to $1.3 million in accordance with 9904.412-50(c)(2)(ii)(A). Pursuant to 9904.412-50(c)(2)(ii)(B), all existing amortization bases maintained in

accordance with 9904.412-50(a)(1) are considered fully amortized. The assignable cost of $1.3 million is then compared to the maximum tax-deductible amount of $1 million. Pursuant to 9904.412-50(c)(2)(iii), Contractor K's assignable pension cost for the period is limited to $1 million. The $300,000 ($1.3 million - $1 million) excess of the assignable cost limitation over the tax-deductible maximum is assigned to future periods as an assignable cost deficit.

(7) * * *

18. Section 9904.412-60(c) is amended by revising Illustration (13) read as follows:

(13) The assignable pension cost for Contractor O's qualified defined-benefit plan is $600,000 as of the first day of the plan year. For the same period Contractor O contributes $700,000 on the first day of the plan year. In addition, there exists $75,000 of unfunded actuarial liability that has been separately identified pursuant to 9904.412-50(a)(2). Contractor O may use $75,000 of the contribution in excess of the assignable pension cost to fund this separately identified unfunded actuarial liability, if he so chooses. The effect of the funding is to eliminate the unassignable $75,000 portion of unfunded actuarial liability that had been separately identified and thereby eliminated from the computation of pension costs. Contractor O shall then account for the remaining $25,000 of excess contribution ([$700,000 - $600,000] - $75,000) as a prepayment credit in accordance with 9904.412-50(a)(4).

19. Section 9904.412-60(c) is amended by inserting Illustrations (14) through (17) as follows:

(14) The assignable pension cost for Contractor O's qualified defined-benefit plan is $600,000. The minimum contribution under ERISA is $750,000 before reduction for an ERISA prepayment balance of $50,000. Therefore the minimum required funding amount is $700,000 in accordance with 9904.412-30(a)(17). Pursuant to 9904.412-50(a)(4)(i), the excess of the minimum required funding over the assigned pension cost creates a mandatory prepayment credit of $100,000 ($700,000 - $600,000) as of the first day of the plan year. In accordance with 9904.412-50(a)(4)(i), this mandatory prepayment credit is added to the current balance of the mandatory prepayment account and carried forward to the end of the plan year at the long-term assumed interest rate of 8% in accordance with 9904.412-50(a)(i)(B). The next year the long-term assumed interest rate is revised to 7.5% based on the contractor's updated best-estimate of long

term expectations. At the beginning of the next year, the mandatory prepayment credit of $108,000 ($100,000 x 1.08) for the prior year is amortized and assigned to the current and future periods as a mandatory prepayment charge in 5 level installments of $24,831 based on the new long-term assumed interest rate of 7.5%.

(15) Assume that Contractor O in Illustration 9904.412-60(c)(14) was required by ERISA to waive, i.e., permanently forgo the $50,000 ERISA prepayment balance due to the plan's level of unfunded actuarial liability. In this case, the minimum required funding is $750,000 since it is not reduced by the amount of waived prepayment balance.

(16) Assume the same facts for Contractor O in Illustration 9904.412-60(c)(14), except that the assigned pension cost for the qualified defined-benefit plan is $600,000, the minimum contribution under ERISA is $500,000 and the mandatory prepayment charge is $16,554. The value of the mandatory prepayment account is $72,000. Pursuant to 9904.412-50(a)(4)(i), the entire mandatory prepayment account balance of $72,000 is applied towards the $100,000 ($600,000 - $500,000) of assigned cost in excess of the minimum required funding amount in accordance with 9904.412-50(a)(4)(i). Because the applied mandatory prepayment of $72,000 exceeds the mandatory prepayment charge of $16,554, the mandatory prepayment adjustment to be separately allocated to cost objectives is $0. The mandatory prepayment charge of $72,000 is deducted from the mandatory prepayment account and minimum mandatory prepayment charges are deemed fully amortized. If the contractor funds the remaining $28,000 of assigned pension cost, the entire assigned pension cost will be allocable to cost objectives.

(17) Assume the same facts for Contractor O in Illustration 9904.412-60(c)(16), except that the assigned pension cost for the qualified defined-benefit plan is $600,000, the minimum contribution under ERISA is $590,000 and the minimum mandatory prepayment charge is $16,554. The current balance of the mandatory prepayment account is $72,000. Pursuant to 9904.412-50(a)(4)(i), $10,000 of the mandatory prepayment account balance is applied towards the $10,000 ($600,000 - $590,000) of assigned cost in excess of the minimum required funding amount. Because the mandatory prepayment charge of $16,554 exceeds the applied mandatory prepayment of $10,000, the mandatory prepayment adjustment to be separately allocated to cost objectives is $6,554 ($16,554 - $10,000). Furthermore, the minimum mandatory prepayment charge of $16,554 is deducted from the mandatory prepayment account, and the balance of the

mandatory prepayment account continues to be assignable to future periods.

(d) Allocation of pension cost.

(1) * * *

20. Section 9904.412-60(d) is amended by revising Illustration (4) read as follows:

(4) Again, assume the set of facts in 9904.412-60(d)(2) except that, Contractor P's contribution to the Trust is $105,000 based on a long-term assumed interest assumption of 8%. Under the provisions of 9904.412-50(d)(2) the entire $100,000 is allocable to cost objectives of the period. In accordance with the provisions of 9904.412-50(c)(1) Contractor P has funded $5,000 ($105,000 - $100,000) in excess of the assigned pension cost for the period. The $5,000 shall be accounted for as a voluntary prepayment credit. Pursuant to 9904.412-50(a)(4), the $5,000 shall be adjusted for interest at funding agency's 8% rate of return and excluded from the actuarial value of assets used to compute the next year's pension cost computations. The value of the voluntary prepayment account of $5,400 (5,000 x 1.08) may be used to fund the next year's assigned pension cost, if needed after the minimum required funding amount and mandatory prepayment credits are applied in accordance with 9904.412-50(a)(4)(ii)(D).

(5) * * *

21. Section 9904.412-60(d) is amended by adding Illustration (8) as follows:

(8) For Contractor O in Illustration 9904.412-60(c)(17), assume that the assigned pension cost of $600,000 for the next year is funded and allocable. The total allocable pension cost for that period is $606,554, which is the sum of the $6,554 mandatory prepayment adjustment plus that year's assigned and funded pension cost of $600,000.

9904.412-61 * * *

9904.412-62 * * *

9904.412-63 Effective date.

22. Section 9904.412-63 is amended by revising paragraphs (1) through (3) as follows:

(a) This Standard is effective as of [Insert date FINAL RULE published in the Federal Register, 2009]. The prior version of this Standard was effective as of March 30, 1995.

(b) This Standard shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow the version of the Standard in 9904.412 in effect prior to [Insert date FINAL RULE published in the Federal Register], 2009, until this Standard, as amended and effective as of [Insert date FINAL RULE published in the Federal Register, 2009], becomes applicable following receipt of a contract or subcontract to which this Standard applies.

23. Section 9904.412-63 is amended by designating Section CAS 412-64 as the transition rule for the prior March 30, 1995 version of the Standard as follows:

9904.412-64 Transition Method for March 30, 1995 Amendments to this Standard.

(a) * * *

24. Section 9904.412 is amended by adding Section CAS 412-64.1 which reads:

9904.412-64.1 Transition Method for [Insert date FINAL RULE published in the Federal Register], 2009 Amendments to this Standard..

Contractors that were subject to this Standard prior to [Insert date FINAL RULE published in the Federal Register], 2009 shall recognize the change in cost accounting method due to this amendment over the initial five-years of applicability, determined in accordance with 9904.412-63(c), as follows:

(a) Measurement of Assigned Pension Costs. Beginning with the first pension plan year coincident with or next following the award of a contract subject to this Standard, as amended [Insert date FINAL RULE published in the Federal Register], 2009, the adjustment of the actuarial accrued liability and normal cost measured in accordance with 9904.412-40(b)(3)(i) for each year of the 5-year transition period shall be multiplied by a percentage based on the year of applicability for this Standard. The percentages are as follows: 20% First Year, 40% Second Year, 60% Third Year, 80% Fourth Year, 100% thereafter.

(b) Amortization of Mandatory Prepayment Credits. In accordance with 9904.412-50(c)(1)(i), the amortization shall begin in pension plan year following the creation of the mandatory prepayment credit. The applicable amortization period shall be as follows: 12 years for amortization beginning the First Year, 10 years for amortization beginning the Second Year, 8 years for amortization beginning the Third Year, 6 years for amortization beginning the Fourth Year, and 5 Years thereafter.

(c) Accumulated Value of Prepayment Credits from Prior Years.

(1) The accumulated value of mandatory prepayment credits existing at the beginning of the first pension plan year subject to this amended Standard shall be divided into 5 equal portions. The amortization of these portions shall be staggered over the first five years beginning with the year that this amended Standard is applicable. Each portion shall be amortized in level annual installments in accordance with paragraph (b) above. The level annual installments shall include an interest equivalent based on the prevailing valuation interest rate.

(2) The contractor shall separately identify the accumulated value of mandatory and voluntary prepayment credits from prior years. To the extent that such separate identification cannot be provided, the prior period prepayment credits shall be deemed to be voluntary prepayments.

(d) Transition illustrations.

(1) Assume that in the second year that this amendment is applicable, Contractor J in Illustration

9904.412-60(c)(1) again measures $18 million as the actuarial accrued liability, $20 million as the minimum actuarial liability, $4 million as the normal cost and $4.5 million as the minimum normal cost. Under 9904.412-64.1(a), the $2 million excess of the minimum actuarial liability over the actuarial accrued liability and the $0.5 million excess of the minimum normal cost over the normal cost are multiplied by 40%. The actuarial accrued liability is increased to $18.8 million ($18 million + 40% x $2 million) and the normal cost is increased to $4.2 million ($4 million + 40% x $0.5 million).

(2) Assume that Contractor O in Illustration 9904.412-60(c)(14) has a minimum required funding amount of $700,000 and an assigned pension cost of $600,000 in the third year this amendment is applicable. The mandatory prepayment credit of $100,000 ($700,000 - $600,000) must be brought forward to the next year at the current long-term interest assumption and amortized over 6 years beginning in the fourth year that this amendment applies as required by 9904.412-64.1(b).

(3) Assume that for the first plan year that this amendment applies, Contractor O has $240,000 of accumulated value of prepayment credits from periods prior to the applicability date. After comparing his prior assigned pension costs to the prior minimum required funding amounts under ERISA, the contractor identifies a $140,000 accumulated value of mandatory prepayment credits and $100,000 accumulated value of voluntary prepayment credits. Pursuant to 9904.412-64.1(c), the contractor divides the $140,000 mandatory prepayment account, *i.e.*, the accumulated value of mandatory prepayment credits, into 5 equal portions of $28,000 each. For the first year, a mandatory prepayment charge of $3,367 is measured to amortize one $28,000 portion of mandatory prepayment credits at the valuation interest assumption of 7.5% over 12 years from the first year this amendment is applicable. Because the minimum required funding amount exceeds the assigned pension cost, the $3,367 mandatory prepayment charge is allocable to cost objectives in addition to the funded portion of the assigned pension cost. In the second year, the first $28,000 increment of mandatory prepayment credits is reduced by the $3,367 mandatory prepayment charge and increased by $1,847 interest at assumed valuation rate of 7.5% interest to an updated value of 26,480 ([$28,000-$3,367] x 1.075). The four unamortized $28,000 increments of mandatory prepayment credits are updated to $30,100 at the valuation interest assumption of 7.5% ($28,000 x 1.075). In the second year, the contractor begins amortizing second increment of mandatory prepayment credits, which is now $30,100, over 10 years at the assumed valuation interest rate of 7.5%. This second amortization installment is $4,079. This

process continues until all five increments of mandatory prepayment credit are amortized or otherwise liquidated by applied mandatory prepayments.

9904.413 Adjustment and allocation of pension cost.

*** * ***

9904.413-30 Definitions.

(a) * * *

(1) * * *

25. Section 9904.413-30(a) is amended by deleting paragraph (16).

26. Section 9904.413-30(a) is amended by renumbering paragraphs (17) through (21) as (18) through (22).

27. Section 9904.413-30(a) is amended by renumbering paragraphs (11) through (15) as (13) through (17).

28. Section 9904.413-30(a) is amended by renumbering paragraph (10) as paragraph (11).

29. Section 9904.413-30(a) is amended by inserting new paragraph (10) as follows:

(10) Mandatory prepayment credit means the amount of the minimum required funding in excess of the pension cost assigned to a cost accounting period. Mandatory prepayment charge means

the minimum amount of a mandatory prepayment credit that is applied towards funding of the assigned pension cost or separately allocated to cost objectives. Applied mandatory prepayment means the mandatory prepayment credits used to fund the assigned pension cost. Mandatory prepayment account means the value, as of the measurement date, of the mandatory prepayment credits adjusted for interest at the long-term assumed rate of interest and decreased by applied mandatory prepayments and separately allocated mandatory prepayment charges during the current period.

30. Section 9904.413-30(a) is amended by inserting new paragraph (12) to read:

(12) Minimum Actuarial Liability means the actuarial accrued liability measured under the accrued benefit cost method and using an interest rate assumption as described in 9904.412-50(b)(3)(ii). Minimum Normal Cost means the normal cost measured under the accrued benefit cost method on the same basis as the minimum actuarial liability.

31. Section 9904.413-30(a) is amended by inserting new paragraph (23) as follows:

(23) Voluntary prepayment credit means the amount of the minimum required funding in excess of the pension cost assigned to a cost accounting period. Applied voluntary prepayment means the voluntary prepayment credits used to fund the assigned pension cost. Voluntary prepayment account means the value, as of the measurement date, of the voluntary prepayment credits adjusted for interest at the actual investment rate of return and decreased by applied voluntary prepayments during the current period.

9904.413-40 * * *

(a) * * *

32. Section 9904.413-40 is amended by revising paragraph (c) to read:

(c) <u>Allocation of pension cost to segments</u>. Contractors shall allocate pension costs to each segment having participants in a pension plan. A separate calculation of pension costs for a segment is required

when the conditions set forth in 9904.413-50(c)(2) or (3) are present. When these conditions are not present, allocations may be made by calculating a composite pension cost for two or more segments and allocating this cost to these segments by means of an allocation base. When pension costs are separately computed for a segment or segments, the provisions of Cost Accounting Standard 9904.412 regarding the assignable cost limitation shall be based on the actuarial value of assets, adjusted in accordance with 9904.412-50(a)(4)(iii), and the actuarial accrued liability for the segment or segments for purposes of such computations. In addition, for purposes of 9904.412-50(c)(2)(iii), the amount of pension cost assignable to a segment or segments shall not exceed its or their allocation portion of the sum of (i) the maximum tax-deductible amount computed for the plan as a whole plus (ii) the value of the mandatory prepayment account and (iii) the value of the voluntary prepayment account, as apportioned among the segment(s).

9904.413-50 Techniques for application.

(a) Assignment of actuarial gains and losses.

(1) * * *

33. Section 9904.413-50(a) is amended by revising paragraph (2) to read:

(2) Actuarial gains and losses determined under a pension plan whose costs are measured by an immediate-gain actuarial cost method shall be amortized over a 10-year period in equal annual installments, beginning with the date as of which the actuarial valuation is made. The installment for a cost accounting period shall consist of an element for amortization of the gain or loss plus an element for interest on the unamortized balance at the beginning of the period. If the actuarial gain or loss determined for a cost accounting period is not material, the entire gain or loss may be included as a component of the current or ensuing year's pension cost.

(b) Valuation of the assets of a pension plan.

(1) * * *

34. Section 9904.413-50(b) is amended by inserting paragraph (6), which reads:

(6) The market value of the assets of a pension plan shall include the present value of contributions received after the date the market value of plan assets is measured.

(i) Except for qualified defined benefit pension plans, the long-term assumed rate of interest shall be used to determine the present value of such receivable contributions as of the valuation date.

(ii) For qualified defined benefit pension plans, the market value of plan assets shall be based on the present value of contributions made after the end of the plan year and shall be measured in accordance with ERISA.

(iii) The market value of plan assets measured in accordance with (i) or (ii) above shall be the basis for measuring the actuarial value of plan assets in accordance with this Standard.

(c) Allocation of pension cost to segments.

(1) * * *

35. Section 9904.413-50(c) is amended by revising paragraph (1) to read:

(1) For contractors who compute a composite pension cost covering plan participants in two or more segments, the base to be used for allocating such costs shall be representative of the factors on which the pension benefits are based. For example, a base consisting of salaries and wages shall be used for pension costs that are calculated as a percentage of salaries and wages; a base consisting of the number of participants shall be used for pension costs that are calculated as an amount per participant. If pension costs are separately calculated for one or more segments, the contractor shall make a distribution among the segments for the maximum tax-deductible amount, the accumulated value of voluntary and mandatory prepayment credits and the contribution to the funding agency as follows:

(i) When apportioning to the segments the sum of (i) the maximum tax-deductible amount, which is determined for a qualified defined-benefit pension plan as a whole pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 et seq., as amended, plus (ii) the value of the mandatory prepayment account and (iii) the value of the voluntary prepayment account, the contractor shall use a base that considers the otherwise assignable pension costs or the funding levels of the individual segments.

(ii) When apportioning amounts deposited to a funding agency to segments, contractors shall use a base that is representative of the assignable pension costs, determined in accordance with 9904.413-50(c) for the individual segments. However, for qualified defined-benefit pension plans, the contractor may first apportion amounts funded to the segment or segments subject to this Standard.

36. Section 9904.413-50(c) is amended by inserting a new subparagraph (1)(iii) as follows:

(iii) For qualified defined-benefit pension plans, when apportioning to segments an assigned mandatory prepayment adjustment, computed in accordance with 9904.412-50(a)(4)(i)(D), contractors shall use a base that is representative of the factors used to determine pension costs as described in 9904.413-50(c)(1).

37. Section 9904.413-50(c) is amended by revising paragraph (5) as follows:

(5) For a segment whose pension costs are either required to be calculated separately pursuant to paragraph (c)(2) or (c)(3) of this subsection or calculated separately at the election of the contractor, there shall be an initial allocation of a share in the undivided market value of the assets of the pension plan, excluding the accumulated values of mandatory and voluntary prepayments, to that segment, as follows:

(i) * * *

38. Section 9904.413-50(c) is amended by revising subparagraphs (12)(i) and (ii) to read:

(i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs. However, the accrued benefit cost method actuarial accrued liability shall not be less than the minimum actuarial liability. If there is a pension plan termination, the actuarial accrued liability shall be measured as the amount paid to irrevocably settle all benefit obligations or paid to the Pension Benefit Guarantee Corporation.

(ii) In computing the market value of assets for the segment, if the contractor has not already allocated assets to the segment, such an allocation shall be made in accordance with the requirements of paragraphs (c)(5)(i) and (ii) of this subsection. The market value of the assets shall be reduced by the values of the mandatory and voluntary prepayment accounts. Conversely, the market value of the assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).

39. Section 9904.413-50(c) is amended by inserting subparagraph (12)(viii) which reads:

(viii) If a benefit curtailment is caused by a cessation of benefit accrual mandated by ERISA based on the plan's funding level, and it is expected that such accruals will recommence in a later period, then no adjustment amount for the curtailment of benefit pursuant to this paragraph (c)(12) is required. Instead, the curtailment of benefits shall be recognized as an actuarial gain or loss for the period. Likewise the recommencement of benefit accruals shall be recognized as an actuarial gain or loss in the period in which benefits recommenced. If the written plan document provides that benefit accruals will be retroactively restored, then the intervening valuations shall continue to recognize the accruals in the actuarial accrued liability and normal cost during the period of cessation.

9904.413-60 Illustrations.

40. Section 9904.413-60 is amended by revising illustration (a) to read:

(a) Assignment of actuarial gains and losses. Contractor A has a defined-benefit pension plan whose costs are measured under an immediate-gain actuarial cost method. The contractor makes actuarial valuations every other year. In the past, at each valuation date, the contractor has calculated the actuarial gains and losses that have occurred since the previous valuation date and has merged such gains and losses with the unfunded actuarial liabilities that are being amortized. Pursuant to 9904.413-40(a), the contractor must make an actuarial valuation annually. Any actuarial gains or losses measured must be separately amortized over a 10-year period beginning with the period for which the actuarial valuation is made in accordance with 9904.413-50(a)(1) and (2).

(b) Valuation of the assets of a pension plan.

(1) * * *

41. Section 9904.413-60(b) is amended by inserting illustration (3):

(3) Assume that besides the market value of assets of $10 million that Contractor B has on the valuation date of January 1, 2014, the contractor makes a contribution of $100,000 on July 1, 2014 to cover its prior year's pension cost. For ERISA purposes, the contractor measures $98,000 as the present value of the contribution on January 1, 2014 and therefore recognizes $10,098,000 as the market value of assets. The contractor must also use this market value of assets for contract costing purposes as required by 9904.413-50(b)6)(ii). The actuarial value of assets must also reflect the $98,000 present value of the July 1, 2014 contribution.

(4) * * *

(c) Allocation of pension costs to segments.

(1) * * *

42. Section 9904.413-60(c) is amended by revising illustration (14):

(14) Contractor O does not renew its government contract and decides to not seek additional government contracts for the affected segment. The contractor reduces the work force of the segment that had been dedicated to the government contract and converts the segment's operations to purely commercial work. In accordance with 9904.413-30(a)(20)(iii), the segment has closed. Immediately prior to the end of the contract the market value of the segment's assets was $20 million and the actuarial accrued liability determined under the actuarial cost method in use was $22 million. An actuarial accrued liability of $16 million is determined using the accrued benefit cost method as required by 9904.413-50(c)(12)(i). However, the minimum actuarial liability is $18 million. Therefore, in accordance with 9904.413-50(c)(12)(i), $18 million is the liability that must be used to measure the segment closing adjustment of $2 million ($20 million - $18 million).

(15) * * *

43. Section 9904.413-60(c) is amended by inserting illustration (26):

(26) Assume the same facts as Illustration 9904.413-60(c)(20), except that ERISA required Contractor R to cease benefit accruals. In this case, the segment closing adjustment is exempted by 9904.413-50(c)(12)(viii). If the written plan document provides that benefit accruals will automatically be retroactively reinstated when permitted by ERISA, then the actuarial accrued liability and normal cost measured for contract costing purposes shall continue to recognize the benefit accruals. Otherwise, the actuarial accrued liability and normal cost will not recognize any benefit accruals until and unless the plan is subsequently amended to reinstate the accruals. Furthermore, the decrease in the actuarial accrued liability will be measured as an actuarial gain and amortized in accordance with 9904.413-50(a)(2).

9904.413-61 * * *

9904.413-62 * * *

9904.413-63 Effective date.

44. Section 9904.413-63 is amended by revising paragraphs (1) through (3) as follows:

(a) This Standard is effective as of [Insert date FINAL RULE published in the Federal Register], 2009. The prior version of the Standard was effective as of March 30, 1995.

(b) This Standard shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow the version of the Standard in 9904.412 in effect prior to [Insert date FINAL RULE published in the Federal Register], 2009, until this Standard, as amended and effective [Insert date FINAL RULE published in the Federal Register], 2009, becomes applicable following receipt of a contract or subcontract to which this Standard applies.

45. Section 9904.413-63 is amended by designating Section CAS 413-64 as the transition rule for the prior March 30, 1995 version of the Standard as follows:

9904.413-64 Transition Method for March 30, 1995 Amendments to this Standard**.**

(a) * * *

46. CAS 9904.413 is amended by adding Section CAS 412-64.1 which reads:

<u>9904.413-64.1 Transition Method</u> for [Insert date FINAL RULE published in the Federal Register], 2009 Amendments to this Standard.

Contractors that were subject to this Standard prior to [Insert date FINAL RULE published in the Federal Register] shall recognize the change in contract costs due to this amendment to the Standard over a period of five years as follows:

(a) Amortization of actuarial gains and losses. The amortization of actuarial gains and losses in accordance with 9904.413-40(a) shall be phased-in over the first 5 years this amendment is applicable. The applicable amortization period shall be as follows: 14 years for amortization beginning the First Year, 13 years for amortization beginning the Second Year, 12 years for amortization beginning the Third Year, 11 years for amortization beginning the Fourth Year, and 10 Years thereafter.

(b) Recognition of Change in Accounting Method under this amendment. Beginning with the first pension plan year coincident with or next following the award of a contract subject to this Standard, as amended [Insert date published in the Federal Register], 2009, the assigned pension cost shall be determined in accordance with Section 9904.412-64.1.

(c) Actuarial Accrued Liability recognized under paragraph 413-50(c)(12)(i). The excess, if any, of the minimum actuarial liability over the actuarial accrued liability determined using the accrued benefit cost method for each year shall be multiplied by a percentage based on the year of applicability for this amendment to this Standard. The percentages are as follows: 20% First Year, 40% Second Year, 60% Third Year, 80% Fourth Year, 100% thereafter.

(d) Transition illustrations.

> (1) Assume Contractor A in Illustration 9904.413-60(a)(1) measures an actuarial loss in the second year this amendment applies. The actuarial loss must be amortized over 14 years in accordance with 9904.413-64.1(a).
>
> (2) Assume that Contractor O in Illustration 9904.413-60(c)(14) must measure a segment closing adjustment in the fourth year that this amendment applies. The contractor must multiply the $2 million excess of the $18 million minimum actuarial liability over the $16 million accrued benefit cost method actuarial accrued liability by 80% in accordance with 9904.413-64.1(c). The segment closing adjustment is based on a liability of $17.6 million ($16 million + 80% x $2 million). The segment closing adjustment is $2.4 million ($20 million assets – $17.6 million liability)

H. Technical Corrections

1. Replace the reference to "9904.413-50(a)(2)" in subdivision (C) of 9904.412-50(c)(2)(ii) with "9904.412-50(a)(2)."