OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Part 9904

Cost Accounting Standards: Harmonization of Cost Accounting Standards 412 and 413 With the Pension Protection Act of 2006

AGENCY: Office of Management and Budget (OMB), Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (Board).

ACTION: Proposed rule with request for comments.

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (Board), invites public comments concerning the harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act (PPA) of 2006. The PPA amended the minimum funding requirements for defined benefit pension plans. The PPA required the Board to harmonize with PPA the CAS applicable to the Government reimbursement of the contractor's pension costs. The Board has proposed several changes to harmonize CAS with PPA, including the recognition of a "minimum actuarial liability" consistent with the PPA minimum required contribution. The proposed CAS changes will lessen the difference between the amount of pension cost reimbursable to the contractor in accordance with CAS and the amount of pension contribution required to be made by the contractor as the plan sponsor by PPA.

DATES: Comments must be in writing and must be received by the July 9, 2010.

ADDRESSES: All comments to this Notice of Proposed Rulemaking (NPRM) must be in writing. You may submit your comments via U.S mail. However, 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:

• *Federal eRulemaking Portal:* 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 NPRM" (without quotes) in the Comment or Submission search box, click Go, and follow the instructions for submitting comments.

• *E-mail:* 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;

• *Facsimile:* Comments may also be submitted via facsimile to (202) 395–5105; or

• *Mail:* If you must submit your responses via regular mail, please mail them to: Office of Federal Procurement Policy, 725 17th Street, NW., Room 9013, Washington, DC 20503, *Attn:* Raymond J. M. Wong. Be aware that due to the screening of U.S. mail to this office, there will be several weeks delay in the receipt of mail. Respondents are strongly encouraged to submit responses electronically to ensure timely receipt.

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 NPRM" 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/casb_index_public_comments/* and *http://www.regulations.gov* after the close of the comment period.

For the convenience of the public, a copy of the proposed amendments to Cost Accounting Standards 412 and 413 shown in a "line-in/line-out" format is available at: *http://www.whitehouse.gov/omb/procurement_casb_index_fedreg/* and *http://www.regulations.gov.*

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, the Staff Discussion Paper (SDP).
2. Promulgate an Advance Notice of Proposed Rulemaking (ANPRM).
3. Promulgate a Notice of Proposed Rulemaking (NPRM).
4. Promulgate a Final Rule.

This NPRM is step three of the four-step process.

B. Background and Summary

The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board, is today releasing a Notice of Proposed Rulemaking (NPRM) 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 for, and the tax-deductibility of contributions to, defined benefit pension plans under the Employee Retirement Income Security Act of 1974 (ERISA). Section 106 of the PPA requires the Board to revise Standards 412 and 413 of the CAS to harmonize with the amended ERISA minimum required contribution.

In addition to the proposed changes for harmonization, the Board has proposed several technical corrections to cross references and minor inconsistencies in the current rule. These technical corrections are not intended to change the meaning or provisions of CAS 412 and 413 as currently published. The technical corrections for CAS 412 are being made to paragraphs 9904.412–30(a)(1) and (9), paragraphs 9904.412–50(c)(1), (2) and (5), and paragraph 9904.412–60(c)(13). In CAS 413, the technical corrections are being made to paragraph 9904.413–30(a)(1), subsection 9904.413–40(c), and paragraphs 9904.413–50(c)(1)(i) and 9904.413–60(c)(12).

Prior Promulgations

On July 3, 2007, the Board published a Staff Discussion Paper (SDP) (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 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 employee service, and future salary increases. These assumptions about future events are absent from the settlement approach utilized by PPA.

On September 2, 2008, the Board published the Advance Notice of Proposed Rulemaking (ANPRM) (73 FR 51261) to solicit public views with respect to the Board's statutory requirement to "harmonize" CAS 412 and 413 with the PPA. Respondents were invited to comment on the general approach to harmonization and the proposed amendments to CAS 412 and 413. The ANPRM reflected public comments in response to the SDP and 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).

Because of the complexity and technical nature of the proposed changes, many respondents asked that the Board extend the comment period to permit submission of additional or supplemental public comments. On November 26, 2008, the Board published a notice extending the comment period for the ANPRM (73 FR 72086).

The ANPRM proposed nine general changes to CAS 412 and 413 that were intended to harmonize the CAS with the PPA minimum required contributions while controlling cost volatility between periods. The primary changes proposed by the ANPRM were the recognition of a "minimum actuarial liability," special recognition of "mandatory prepayment credits," an accelerated gain and loss amortization, and a revision of the assignable cost limitation. Other proposed changes addressed the PPA's mandatory cessation of benefit accruals for severely underfunded plans, the projection of flat dollar benefits, recognition of accrued contribution values on a discounted basis, and interest on prepayments credits and prior period unfunded pension costs. The final category of proposed changes provided for a phased-in transition of the amendments to mitigate the initial increase in contract price.

Public Comments

The Board received 17 public comments and 2 supplemental public comments to the ANPRM, including the extension period. These comments came from contractors, industry associations, Federal agencies, and the actuarial profession. The Board appreciates the efforts of all parties that submitted comments, and found their depth and breadth to be very informative. A brief summary of the comments follows in Section C—Public Comments to the ANPRM.

The NPRM reflects public comments in response to the ANPRM, as well as to research accomplished to date by the staff of the Board in the respective subject areas, and is issued by the Board in accordance with the requirements of 41 U.S.C. 422(g).

Conclusions

The Board continues to believe that the accounting for pension costs for Government contract costing purposes should reflect the long-term nature of the pension plan for a going concern. As discussed in the ANPRM, 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 the forward-pricing of Government 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 relatively 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 a wide contribution range that allows the company to establish 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 address the risks to both the contractor and the Government that are associated with inadequate funding of a plan's settlement liability. The NPRM therefore proposes implementation of a minimum actuarial liability and minimum normal cost that is based on currently accrued benefits that have been valued using corporate bond rates. Furthermore, recognition of the minimum actuarial liability and normal cost that are consistent with the basis for the ERISA "funding target" and "target normal cost," will alleviate the disparity between the CAS assigned cost and ERISA's minimum required contribution. Once harmonization is achieved, maintaining the going concern basis for contract costing allows contractors to set long-term funding goals that avoid undue cost or contribution volatility.

The Board agrees with the public comments that since the general approach to harmonization is tied to the minimum actuarial liability, the recognition proposed in the ANPRM for post harmonization "mandatory" prepayment credits was unnecessary and overly complex. In reviewing the proposed treatment of mandatory prepayments, the Board noted that because the normal cost and actuarial accrued liability have been harmonized with the minimum actuarial liability and minimum normal cost, providing for supplemental recognition of the mandatory prepayment credits would overstate the appropriate period cost. The NPRM does not include any special recognition of mandatory prepayment credits.

The Board continues to believe that issues of benefit design, investment strategy, and financial management of 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 accounting theory and reporting as well as Congressional changes to ERISA.

After considering the effects of accelerating the recognition of actuarial gains and losses and to provide more timely adjustment of plan experience without introducing unmanageable volatility, the NPRM proposes changing the amortization period for gains and losses to a 10-year amortization period from its current 15-year period. This shorter amortization period more closely follows the 7-year period

required by ERISA to fully fund the plan's settlement liability.

The Board believes the 10-year minimum amortization period, including the required amortization of any change in unfunded actuarial liability due to switching from the actuarial accrued liability to the minimum actuarial liability, or from the minimum actuarial liability back to the actuarial accrued liability, provides sufficient smoothing of costs to reduce volatility. Therefore, the NPRM does not include any assignable cost limitation buffer. Under the NPRM, once the assignable cost limitation is exceeded, the assigned pension cost continues to be limited to zero.

The Board proposes a specific transition method for implementing harmonization and moderating its cost effects. The proposed 5-year transition method will phase-in the recognition of any adjustment of the actuarial accrued liability and normal cost. This transition method would apply to all contractors subject to CAS 412 and 413.

Benefits

The proposed rule of this NPRM harmonizes the disparity between the PPA minimum contribution requirements and Government contract costing. The 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 Government and contractor budgets. The proposed rule should also reduce cost volatility between periods and thereby enhance the budgeting and forward pricing process. This will assist in meeting the uniformity and consistency requirements described in the Board's Statement of Objectives, Policies and Concepts (57 FR 31036), July 13, 1992).

The NPRM allows companies to use the same actuarial methods and valuation software for ERISA, financial statements, 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 Government agencies and auditors to place reliance on data from ERISA and financial statement valuations while allowing contractors to avoid unnecessary actuarial effort and expense.

Goals for Harmonization

This proposed rule is based upon the following goals for achieving pension harmonization and transition that the Board established in the ANPRM and reaffirms in this NPRM:

(1) Harmonization Goals

(a) Minimal changes to CAS 412 and 413.

(b) No direct adoption of ERISA as amended by the 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) Mitigate volatility (enhance predictably).

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

(2) Goals for Transition to Harmonization

(a) Minimize undue immediate impact on contract prices and budgets.

(b) Transition should work for contractors with either CAS or FAR covered contracts.

Summary Description of Proposed Standard

The primary proposed harmonization provisions are self-contained within the "CAS Harmonization Rule" at 9904.412–50(b)(7). This structure eliminates the need to revise many long-standing provisions and clearly identifies the special accounting required for harmonization. Proposed revisions to other provisions are necessary to harmonization and mitigate volatility. This proposed rule makes 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 and normal cost based on long-term, "best-estimate" actuarial assumptions, projected benefits, and the contractor's established immediate gain actuarial cost method. However, in order to ensure that the measured costs recognize the settlement liability and normal cost as minimum values, the proposed rule requires that the measured pension cost must be re-determined using the minimum actuarial liability and minimum normal cost if the criteria of all three (3) "triggers" set forth in the CAS Harmonization Rule are met.

(i) If the minimum required amount exceeds the pension cost measured without regard to the minimum liability and minimum normal cost, then the contractor must determine which total period liability, *i.e.,* actuarial liability plus normal cost, must be used;

(ii) If the sum of the minimum actuarial liability plus the minimum normal cost measured on a settlement basis exceeds the sum of actuarial accrued liability plus normal cost measured on a long-term basis, then the contractor must re-measure the pension cost for the period using the minimum actuarial liability and minimum normal cost; and

(iii) If pension cost re-measured using the minimum actuarial liability and minimum normal cost exceeds the pension cost originally measured using the actuarial accrued liability and normal cost, then the re-measured pension cost is used for the assignment and allocation of pension costs for the period. Furthermore, the minimum actuarial liability and minimum normal costs are used for all purposes of measurement, assignment, and allocation under CAS 412.

The minimum actuarial liability definition is consistent with the PPA funding target and the Statement of Financial Accounting Standard No. 87 (FAS 87) "accumulated benefit obligation." The minimum normal cost is similarly defined to be consistent with the FAS 87 service cost (without salary projection) and the PPA target normal cost.

The 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 and must comply with the provisions of CAS 412 and 413.

(2) Accelerated Gain and Loss Amortization. The proposed rule accelerates the assignment of actuarial gains and losses by decreasing the amortization period from fifteen to ten 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).

(3) Revision of the Assignable Cost Limitation. The proposed rule does not change the basic definition of the assignable cost limitation and continues to limit the assignable cost to zero if assets exceed the actuarial accrued liability and normal cost. Under the proposed rule, the actuarial accrued liability and normal cost used to determine the assignable cost limitation are adjusted for the minimum values if applicable.

(4) Mandatory Cessation of Benefit Accruals. This proposed rule will exempt any curtailment of benefit

accrual required by ERISA from immediate adjustment under CAS 413–50(c)(12). Voluntary benefit curtailments will remain subject to immediate adjustment under CAS 413–50(c)(12). A new subparagraph has been added to CAS 413–50(c)(12) that addresses the accounting for the benefit curtailment or other segment closing adjustment in subsequent periods.

(5) Projection of Flat Dollar Benefits. The 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.

(6) Asset Values and Present Value of Contributions. For nonqualified defined benefit plans, the 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 proposed rule would accept the present value of accrued contributions and the market value (fair value) of assets recognized for ERISA purposes. Using the ERISA recognition of accrued contributions in determining the 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.

(7) Interest on Prepayments Credits. Funding more than the assigned pension cost is often a financial management decision made by the contractor, although funding decisions must consider the minimum funding requirements of ERISA. Since all monies deposited into the funding agency share equally in the fund's investment results, the prepayment is allocated a share of the investment earnings and administrative expenses on the same basis as separately identified segment assets. This recognition ensures that any investment gain or loss attributable to the assets accumulated by prepayments does not affect the gains and losses of the plan or any segments. The decision or requirement to deposit funds in excess of the assigned cost should have a neutral impact on Government contract costing.

(8) Interest on Unfunded Pension Costs. Funding less than the assigned pension cost is a financial management decision made by the contractor. The unfunded cost cannot be reassigned to current or future periods and must be separately identified and tracked in accordance with 9904.412–50(a)(2). Because there are no assets associated with these unfunded accruals, the Board believes that these amounts should not create any investment gain or loss. The proposed rule reaffirms that the accumulated value of unfunded accruals is adjusted at the long-term interest assumption and clarifies that the settlement interest rate based on corporate bond yields does not apply.

(9) Required Amortization of Change in Unfunded Actuarial Liability due to Recognition of Minimum Actuarial Liability Mitigates Initial Increase in Contract Price. The proposed rule explicitly requires that the actuarial gain or loss, due to any difference between the expected and actual unfunded actuarial liability caused by the recognition of the minimum actuarial liability, be amortized over a 10-year period along with actuarial gain or losses from all other sources. This amortization process will limit the immediate effect on pension costs when the Harmonization Rule becomes applicable and thereby mitigates the impact on existing contracts subject to these Standards.

There are two other important features included in this proposed rule.

(1) Transition Phase-In of Minimum Actuarial Liability and Minimum Normal Cost Mitigates Initial Increase in Contract Price. To allow time for agency budgets to manage the possible increase in Government contract costs and to mitigate the impact on existing contracts for both the Government and contractors, the changes to CAS 412 and 413 are phased-in over a 5-year period that approximates the typical contracting cycle. The proposed phase-in allows the cost impact of this draft proposal to be gradually recognized in the pricing of CAS-covered and FAR contracts alike. Any adjustment to the actuarial accrued liability and normal cost based on recognition of the minimum actuarial liability and minimum normal cost 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.

(2) Extended Illustrations. Many existing illustrations have been updated to reflect the proposed changes to CAS 412 and 413. To assist the contractor with understanding how this proposed rule would function, extensive examples have been included in a new Section 9904.412–60.1, Illustrations—CAS Harmonization Rule. This section presents a series of illustrations showing the measurement, assignment and allocation of pension cost for a contractor with an under-funded segment, followed by another series of illustrations showing the measurement, assignment and allocation of pension cost for a contractor with an over-funded segment. The actuarial gain and loss recognition of changes between the long-term liability and the settlement liability bases are illustrated in 9904.412–60.1(h). This structural format differs from the format for 9904.412–60.

The Board realizes that these examples are longer than the typical example in the Standards, but believes that providing comprehensive examples covering the process from measurement to assignment and then allocation will demonstrate how the proposed harmonization is integrated into the existing rule.

C. Public Comments to the Advance Notice of Proposed Rulemaking

The full text of the public comments to the ANPRM is available at: *http://www.whitehouse.gov/omb/casb_index_public_comments/* 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 with Government contracts subject to CAS 412 and 413.

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. Many commenters believed that the ERISA 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 amend 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. There was no consensus on how far the Board should go beyond the requirement to merely harmonize CAS with the PPA minimum required contribution, *e.g.,* should the Board also consider the PPA's revisions to the maximum tax deductible limits.

For the most part, industry comments supported 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 pension plan, are different than the purposes of CAS. They also believed that since CAS does not undermine the purposes of the PPA the two are already in harmony.

This summary of the comments and responses form part of the Board's public record in promulgating this case and are intended to enhance the public's understanding of the Board's deliberations concerning Pension Harmonization.

Abbreviations

Throughout the public comments there are the following commonly used abbreviations:

- AAL—Actuarial Accrued Liability, usually used to denote the liability measured using long-term assumptions;
- ACL—Assignable Cost Limitation;
- ERISA—The Employees' Retirement Security Income Act of 1974, as amended to date;
- MAL—Minimum Actuarial Liability, usually used to denote the liability measured using interest based on current period settlement rates;
- MNC—Minimum Normal Cost, usually used to denote the normal cost measured using interest based on current period settlement rates;
- MPC—Mandatory Prepayment Credit, which was a term used in the ANPRM;
- MRC—Minimum Required Contribution, which is the contribution necessary to satisfy the minimum funding requirement of ERISA for continued plan qualification; and
- NC—Normal Cost, usually used to denote the normal cost measured using long-term assumptions.

Responses to Specific Comments

Topic A: Proposed Approach to Harmonization. The principle elements for harmonization that were proposed in the ANPRM are:

a. Continuance of the development of the CAS assigned pension cost on a long-term, going concern basis;

b. Implementation of a minimum liability "floor" based on the plan's current settlement liability in the computation of the assigned cost for a period;

c. Acceleration of the gain and loss amortization from 15 to 10 years;

d. Recognition of established patterns of increasing flat dollar benefits;

e. Adjusting prepayment credits based on the rate of return on assets; and

f. Exemption of mandated benefit curtailments.

Comments: The majority of commenters found that the ANPRM presented a fair and reasonable approach to harmonization. The commenters submitted many detailed comments on improvements to specific provisions as well as some additional provisions they believed might be useful. Some commenters remarked that the extensive explanation of the reasoning behind the Board's approach to harmonization enhanced their understanding of the ANPRM.

As one commenter wrote:

> We appreciate the effort put forth by the CAS Board and Staff to study the issues and publish this ANPRM. The task of harmonization is challenging and technically complicated. The harmonization of CAS needs to respect the cash contribution requirements mandated by the PPA, but it should be done in a way that best allows both contractors and the government to budget for that cost and for the contractors to recover that cost. The ANPRM provides an excellent framework for developing revisions to the CAS in order to satisfy the requirements for harmonization with PPA. However, we believe that there are several areas where changes to the ANPRM would offer significant improvement toward meeting the objective of harmonization.

Another public comment read:

> We commend the CAS Board for addressing the complex issues concerning harmonizing pension costs under the CAS 412/413 requirements with the minimum funding requirements under the Pension Protection Act (PPA) of 2006. We believe the ANPRM reflects an excellent approach for addressing these important issues.

Commenting on the proposed approach and preamble explanation, a commenter remarked:

> Although the ANPRM does not establish as much commonality between the building blocks underlying the CAS cost and ERISA minimum funding requirements as we would have preferred, the explanation of the Board's reasoning was quite helpful. In our view, the ANPRM provides a reasonable framework for the necessary revisions to CAS 412 and 413.

Response: The majority of commenters found that the ANPRM presented a fair and reasonable approach to harmonization, and therefore this NPRM is being proposed based upon the general concepts of the ANPRM. In drafting this NPRM the Board has considered many detailed suggestions concerning improvements to specific provisions and additional provisions as submitted by the commenters. Because of the technical nature of this proposed rule, the Board is again providing explanations of the reasoning for any changes from the ANPRM.

The Board discussed the move towards fair value accounting by generally accepted accounting

principles (GAAP) and ERISA versus the CAS goal of accounting on long-term, "going concern" basis. The Board reaffirmed its desire to retain the "going concern" basis and use long-term expectations to value pension liabilities—this recognizes the long-term relationship between the Government and most contractors. The long-term, "going concern" basis serves to dampen volatility and thereby enhances forward pricing—a function that is unique to the CAS.

The Board also believes that the minimum liability approach is the highest extent of change which is academically/theoretically defensible and consistent with the Board's Statement of Objectives, Principles and Concepts.

Topic B: Supports Comments Submitted by AIA/NDIA, Some Have Supplemental Comments.

Comments: Seven (7) of the contractors submitting comments also stated that they support the comments submitted by industry associations. Several of these commenters also stated their comments augmented the industry associations.

Response: The Board has given full attention to the comments submitted by AIA/NDIA because of their general support by other commenters, and because their very detailed comments and proposed revisions reflect thoughtfulness and appreciation for the special concerns of contract cost accounting.

Topic C: General Comments on Differences between CAS, GAAP and ERISA (PPA). The SDP and ANPRM discussed the similarities and distinctions between the goals and measurement criteria of CAS, GAAP and ERISA. The unique purpose and goal of the CAS was determinative of the Board's proposed harmonization approach.

Comments: Several Commenters noted that ERISA, as amended by the PPA, is intended to promote adequate funding of the currently accrued pension benefit and set reasonable limits on tax deductibility. These commenters remarked that the PPA minimum contribution is designed to fully fund the current settlement liability of a plan within 7 years in order to protect the participants' accrued benefit and to limit risk to the PBGC.

As one commenter explained:

> The PPA was enacted, in part, as a response to the failure of companies with severely underfunded qualified defined benefit pension plans ("pension plans"), even though companies had typically contributed at least the minimum amount required under the Internal Revenue Service ("IRS") rules. PPA was designed to ensure that corporations would fund towards liabilities measured on more of a settlement basis over a 7-year period, so that plans would be less likely to be severely underfunded.

They remarked that GAAP has adopted fair value accounting, also known as "mark-to-market" accounting. The purpose of GAAP is to disclose the current period pension expense based on the current period's environment, including the volatility associated with a changing environment. Another primary concern of GAAP is disclosing the risk associated with the funding of the current settlement liability to users of financial statement.

Two commenters reminded the Board that the purpose of CAS is (i) consistency between periods and (ii) uniformity between contractors. Unlike ERISA and GAAP, CAS is concerned with the cost data used to price contracts over multiple periods. The CAS continues to be concerned with the Government's participation in the funding of the long-term pension liability via a continuing relationship (going concern) with the contractor.

One of these commenters felt that use of the PPA and GAAP interest assumption and cost method used to determine the liability and normal cost for CAS measurements would enhance uniformity between contractors. This commenter also believes that 10-year amortization of gains and losses and the amortization of mandatory prepayment credits would sufficiently mitigate any excessive volatility and therefore not harm consistency between periods. Finally, this commenter suggested that adoption of the PPA interest assumption and cost method would alleviate the need to have the complex mandatory prepayment reconciliation rules. Moreover, if the CAS values were based on fair value accounting used by ERISA and GAAP, the Government would be able to place reliance on measurements that were subject to independent review.

As this commenter articulated these concerns:

> The proposed rule relies on the same fundamental approach for measuring pension liabilities that has been in effect since the CAS pension rules were first adopted in 1975. The CAS allows a contractor to choose between several actuarial cost methods and requires that the discount rate represent the expected long-term rate of return on plan assets. Although the CAS measurement basis was once consistent with the methods and assumptions in common use, this is no longer the case. In 1985, the Financial Accounting Standards (FAS) were modified to require that pension costs for financial reporting purposes be calculated using the projected unit credit (PUC) cost method and a discount rate that reflects the rates of return currently available on high-quality corporate bonds of appropriate duration. In 2006, the Employee Retirement Income Security Act (ERISA) was amended by the PPA to require the use of durational discount rates that are determined in a manner consistent with the FAS. The PPA also requires all plans to use the unit credit cost method (PUC without projection) to determine minimum funding, and the PUC method to determine the maximum tax deductible contribution.
>
> These are material conflicts with the CASB objectives. We see no way to resolve the conflicts except to modify the CAS to require pension liabilities to be determined in a manner consistent with the measurements used for both ERISA and financial reporting. Specifically, the CAS should require the use of (i) the PUC cost method, and (ii) a discount rate that reflects the rates of return currently available on high-quality corporate bonds of appropriate duration. These changes would also improve consistency between contractors, a primary objective of the CAS.

Response: The goal of the ANPRM was to maintain predictability for cost measurement and period assignment while providing for reconciliation, *i.e.,* recovery of required contributions within a reasonable timeframe. The divergence of GAAP and ERISA from CAS is primarily due to the adoption of "mark-to-market" cost measurement, which can be disruptive to the contract costing/pricing process.

The Board remains cognizant of the following key distinctions between ERISA, GAAP and CAS regarding funding of the pension cost:

- ERISA's minimum funding is concerned with the funding of the current settlement liability.
- GAAP is not concerned with funding, but rather with the disclosure of the results of operations in the current market environment.
- CAS continues to be concerned with the Government's participation in the funding of the long-term pension liability via a continuing (going concern) relationship with the contractor. CAS 412 and 413 are used to develop data for forward pricing over multiple years, and is not just concerned with the current environment.

The Board wishes to retain the contractor's flexibility to choose the actuarial cost method it deems most appropriate for its unique pension plan. While the CAS permits the use of any immediate gain cost method, most contractors already use the projected unit cost method, which is required by ERISA and GAAP and compliant with CAS 9904.412–40(b)(1). As long as the current CAS permits the use of methods required by the PPA there is no reason to revise the CAS to be more restrictive. Furthermore, the Board notes that for

CAS purposes a contractor may use the same actuarial cost method and assumptions, except for the long-term interest assumption, as used to value a plan under PPA that is not "At Risk." (With the passage of the PPA, ERISA no longer computes liabilities and normal costs using long-term interest assumptions.)

The Board believes that the proposed 10-year amortization of the gains and losses will sufficiently harmonize CAS with the PPA while provide acceptable smoothing of costs between most periods. The Board notes that the plunge in stock market values in the latter half of 2008 demonstrates how quickly things can change between periods, but remains confident that the aberrant market losses for 2008 and early 2009 will be adequately smoothed using 10 versus 15 years.

Topic D: Tension between Verifiability and Predictability.

Comments: One commenter also raised the issue of verifiability, writing:

In 1992, the CASB released a *Statement of Objectives, Policies, and Concepts,* which cites two primary goals for cost accounting standards: (i) Consistency between contractors, and (ii) consistency over time for an individual contractor. It also sets forth other important criteria to be taken into consideration. Verifiability is described as a key goal for any cost accounting standard, as is a reasonable balance between a standard's costs and benefits. We believe that the liability measurement basis under the proposed rule severely conflicts with these goals.

This commenter was concerned that verifiability of the liability and cost data might be compromised or lost since the GAAP expense and ERISA contributions are no longer based on a long-term, "going concern" concept. This commenter also was concerned with the added expense of producing such numbers and the potential for disputes. This commenter stated:

The pension liabilities used to develop contract costs must be verifiable. If the data used for contract costs are not reconcilable with the data used for other reporting purposes, the information will be open to bias and manipulation.

Similarly, if the pension liabilities determined in accordance with the CAS are inconsistent with those used for other purposes, there will be no alternative source from which to obtain this information. We have encountered many situations in which a contractor was not aware of the requirement to compute a special cost for contract reimbursement or did not maintain the CAS information required for audit or segment closing calculation. In these cases, ERISA reports or financial statements were used to obtain the necessary liability information, and the CAS computations could be reconstructed. The data required under the proposed rule are obsolete for other reporting purposes and will not be available if the calculations required under the CAS are not performed, or if the documentation is not retained. It will be difficult or impossible to develop reliable estimates from existing sources of data.

This commenter was also concerned that actuaries of medium-sized contractors may not be sufficiently familiar with the CAS rules, and some of the younger practitioners may not be that familiar with the concepts of long-term measurement methods. On occasion, the plan's actuary may not be aware that his client has Government contracts and therefore the required valuation data may not be produced.

Conversely, another commenter was receptive to use of the fair market accounting liability as a minimum liability, but was concerned that introduction of the current liability minimum might cause the CAS to diverge from its long-standing goal of "predictability." This commenter wrote:

Because the proposed rule contains many technical and actuarial provisions, I am concerned that the basic purpose of CAS, which differs from those of other accounting standards and rules, may be lost in the details.

This commenter said that the Board should not lose sight of predictability (consistency between periods). Focusing on uniformity between contractors, which is a concern of GAAP, might come at the expense of predictability and harm the pricing function. This commenter opines:

The CAS has been, and I agree the CAS should continue to be, concerned with predictably (minimal volatility) across cost accounting periods to support the estimating, accumulating and reporting of costs for flexibly and fixed price contracts. Fair value accounting of the liability (also called "mark-to-market" accounting) may be appropriate for financial disclosure purposes under GAAP, but is inappropriate and disruptive of the contract costing function. Likewise, ERISA's mandates and limits for current period funding are inappropriate for cost predictability and stability across periods.

I fully support the following goals for pension harmonization as stated in the paragraph entitled "(1) Harmonization Goals" of the Board's ANPRM:

(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 it is quite likely that Congress will amend ERISA in the future.

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

(e) Mitigate volatility (enhance predictably).

This commenter also remarked that balancing the tension between ERISA and the CAS has long been a concern of the Board, writing as follows:

Harmonization is not a new subject to the CAS Board. Even in the early 1990s the matching of ERISA funding and contract cost accruals was of concern to the staff. The SDP continues:

The costing and pricing of Government contracts also requires a systematic scheme for accruing pension cost that precludes the arbitrary assignment of costs to one fiscal period rather than another to gain a pricing advantage. The Government also has sensitivity to the inclusion of unfunded pension costs in contract prices. Conversely, the staff's research revealed one instance of a contractor who, due to the shortened amortization periods now contained in the Tax Code, faced minimum ERISA funding requirements in excess of the CAS 412 pension cost and, thus could not be reimbursed. That particular contractor felt, understandably, that allowability ought to be tied to funding under the Tax Code. Obviously, given the current tax law climate regarding full funding, complete realization of all of these goals is not achievable. In the staff's opinion, the goals of predictable and systematic accrual outrank that of funding. However, funding still remains an important consideration.

Response: The Board recognizes that there is a tension between the benefits of verifiability, *i.e.,* reliance on outside audited data, and predictability, *i.e.,* stability or at least minimized volatility. Most of the commenters expressed positive opinions concerning the general approach of the ANPRM and do not seem overly concerned with the verifiability issue. Verifiability is always an audit issue and will remain a consideration as the Board proceeds.

Contractors are required to provide adequate documentation to support all cost submissions, including pension costs. Furthermore, the American Academy of Actuaries' "Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States" expressly requires actuaries to be professionally qualified and adhere to CAS 412 and 413—Actuarial communications and opinions regarding CAS 412 and 413 are recognized as "Statements of Actuarial Opinion." Paragraph 3.3.3 of Actuarial Standards of Practice No. 41 requires actuaries to provide information that is sufficient for another actuary, qualified in the same practice area, to make an objective appraisal of the reasonableness of the actuary's work as presented in the actuary's report.

As discussed above, since a contractor may use for CAS the same actuarial cost method and assumptions, except for the long-term interest assumption, as used for valuing a plan under PPA that is not "At Risk," there is a commonality to the values measured for CAS and PPA. There will some additional effort expended since the contractor and its

actuary will have to reconcile the liability and normal cost measured under different interest rates. However demonstrating the difference caused by the change of a single variable should not impose an undue burden or expense.

Topic E: CAS 412.40(b)(3)(ii) Harmonization Rule's Minimum Actuarial Liability Interest Rate Assumption.

Comments: Most commenters asked that the rule clearly identify the allowable basis for the interest rate used to measure the MAL. Some asked that a particular basis for the rate be stated or permitted, *i.e.,* PPA or FAS 87as a "safe harbor". PPA allows some leeway and therefore one commenter said that it was not clear as to the date the current bond rate would be measured. Others believed that the MAL should be based on a long-term assumed rate for corporate bonds, instead of the current PPA rate, in order to reduce volatility and enhance forward pricing.

One commenter asked that the rule permit the use of a single interest rate for the plan rather than separate rates by PPA segment or full yield curve. Another commenter asked that the Board provide examples illustrating selection and use of the interest rate.

The following captures the theme of many comments submitted:

* * * First, our comments regard the Interest Rate used for the Minimum Actuarial Liability (MAL) and Minimum Normal Cost (MNC). We believe the flexibility provided by using "the contractors' best estimate" for selecting the source of the interest rate used in the calculation of the MAL and MNC is desirable to achieve a meaningful measure of the resulting pension cost for each contractor. However, we have concerns that the criteria for the acceptable rates as written are sufficiently unclear as to create a significant exposure for interpretive disagreements. For example, we believe that the ANPRM criteria as written allows for the use of a very short term rate or a very long term rate, since either may reflect the rate at which pension benefits could be effectively settled at a current or future period, respectively. We encourage the CAS Board to adopt the industry recommendation of inserting two new sentences after the first sentence in CAS 412–40(b)(3)(ii) to read, "Acceptable interest rates selected by the contractor are those used for the PPA funding target, FASB 87 discount rate, long term bond rate, or another such reasonable measure. A contractor shall select and consistently follow a policy for the source of the interest rate used for the calculation of the minimum actuarial liability and minimum normal cost."

There was some concern expressed about the volatility between periods caused the use of current corporate bond rates. As commenter noted:

History shows that the FAS discount rate leads to volatile pension expense as the discount rate changes from one measurement date to the next. Exhibit A provides a monthly history of the Citigroup Pension Liability Index from January 31, 1985 through September 30, 2008. The Citigroup Pension Liability Index is a good proxy for the FAS discount rate. To illustrate how dramatically the index can change over a 12-month period, note that between May 31, 2002 and May 31, 2003, the Index dropped by 172 basis points. Using general actuarial rules of thumb, this drop would translate to a 22% increase in liability and a 41% increase in normal cost.

The interest assumption used for liabilities for determining minimum funding requirements under the PPA is based on high-quality corporate bonds, but PPA allows the plan sponsor the option to use a 24-month average of rates vs. a one month average.

Another commenter discussed the advantage of using an average bond rate, writing:

This result is not consistent with the fundamental desire to strive for predictability of cost in the government contracting arena. The impact that unforeseen changes in cost can have on fixed price contracts is obvious, but even unexpected cost increases on flexibly priced business can place a strain on government budgets. It is important to try to mitigate the potential pitfalls that might create inequitable financial results for either the government or the contractors.

The ANPRM maintains the concept of the actuarial accrued liability (AAL) that is calculated using an interest rate that represents the average long-term expected return on the pension trust fund. This reflects the CAS Board's view of pension funding as a long-term proposition. The ANPRM states that CAS 412 and 413 are concerned with long-term pension funding and minimizing volatility to enhance predictability. Since the new MAL is based on spot bond rates it will experience more volatility from year to year than the AAL. We believe that the addition of the MAL to the CAS calculations is an important change that is very much needed. However instead of measuring the MAL using spot bond rates each year, we feel very strongly that it is important to allow contractors to have an option to calculate the MAL using an expected long-term average bond rate. This would allow contractors to use an interest assumption that would not need to be changed each year, and would very significantly reduce the volatility of the MAL and greatly improve predictability of the pension cost. The MAL interest assumption would only need to be changed if it was determined that average future bond yields over a long-term horizon were expected to be materially different from the current MAL assumption. For example, if long-term bond rates were expected to fluctuate between 5.5% and 6.5% in the future, then a valid assumption for the expected average future rate might be 6.0%. So this concept would hold some similarities to the interest rate used for calculating the AAL. The main difference is that the AAL interest rate represents the average expected long-term future return on the investment portfolio, whereas the MAL interest rate would represent the average expected future long-term yield on high-quality corporate bonds. There should obviously be some correlation between the MAL interest rate and the AAL interest rate, so the two different rates should be determined on a consistent basis.

Several commenters suggested that the rule expressly permit use of a long-term rate to improve predictability & reduce volatility. The following is typical of this suggestion:

* * * However, because of the extreme volatility which could result from changes in market interest rates, [we] believes the CAS Board should explicitly take the position either in the standard or the preamble to the final publication, that contractors are permitted to calculate the minimum actuarial liability using a long-term expectation of high-quality bond yields, moving averages of reasonable durations beyond 24 months (a period described elsewhere in the proposed rule) or other techniques which enhance predictability.

Response: The ANPRM sets forth a conceptual description of the settlement rate which would include the corporate bond yield rate required by the PPA. Furthermore, the PPA permits several elections concerning the yield rate, *i.e.,* full or segmented yield curve, current or average yield curve, yield curve as of the valuation date or any of the 4 prior months. The Board agrees that a "safe harbor" should be included for clarity and to avoid disputes. The Board also believes that the election of the specific basis for the settlement interest rate is part of the contractor's cost accounting practice. Accordingly, the proposed rule at 9904.412–50(b)(7)(iv)(B) provides:

The contractor may elect to use the same rate or set of rates, for investment grade corporate bonds of similar duration to the pension benefits, as published or defined by the Government for ERISA purposes. The contractor's cost accounting practice includes any election to use a specific table or set of such rates and must be consistently followed.

The Board reaffirms its belief that the recognition of the more conservative assumptions required for plans whose funding ratio falls below a specific threshold, such as plans deemed "at risk" under the PPA, is inappropriate for the purposes of contract costing. The proposed rule requires that all other actuarial assumptions continue to be based on the contractor's long-term, best-estimate assumptions. (9904.412–50(b)(7)(iii)(B)) (Note that the DS–1, Part VII asks for the basis for selection of assumptions rather than the current numeric value.)

Topic F: Recognition of Minimum Actuarial Liability and Minimum Normal Cost.

Comments: One commenter was concerned with the added complexity

from introduction of the minimum actuarial liability and minimum normal cost into the development of the assignable pension cost as follows:

While the ability to have contractors determine their CAS assignable costs based on liabilities reflecting the yields on high-quality corporate bonds is a significant relief for the negative cash flow issue faced by government contractors, the process for introducing the MAL into the development of the CAS Assignable Costs will result in additional complexity in the calculations.

Several commenters were concerned that the assigned cost would occasionally be larger than necessary under the ANPRM. They believed that the assigned cost based on the adjusted liability would be excessive if the unadjusted assigned cost already exceeded the PPA minimum contribution. Some commenters recommended that the assigned pension cost be adjusted based upon a revised assigned pension cost only if the PPA minimum required contribution, without reduction for any credit balances, exceeds the assigned cost as measured on a long-term basis. As one commenter explained:

There can be situations where the CAS assignable cost developed without regard to the MAL would be larger than the PPA funding requirement. Regardless of this situation, under the ANPRM, if the MAL is higher than the regular AAL, the liabilities and normal costs will be adjusted to reflect the MAL and the MNC. This adjustment will result in even higher CAS assignable costs

This commenter suggested an alternative approach as follows:

Instead of applying minimums to the liabilities and normal costs used in the calculation of the CAS assignable cost, we present the following alternative (which we shall refer to as the "Minimum CAS Cost" alternative) for consideration and further study. We believe this alternative addresses the Board's goals of minimizing changes to CAS 412 and 413 and avoiding complexity as much as possible, while addressing the difference between CAS assignable costs and PPA minimum required contributions.

We believe this alternative will lead to less volatile CAS assignable costs compared to the ANPRM. In Attachment II, we compare results under this approach and under the ANPRM for a hypothetical sample. We recommend further study of this approach.

Under this alternative, the CAS assignable cost will be the greater of (a) and (b) below:

(a) The Regular CAS Cost, which is the CAS cost determined without regard to the CAS Harmonization Rule (*i.e.,* as determined under the current CAS 412 but with a 10-year amortization of gains/losses as proposed under the ANPRM),

(b) the Minimum CAS Cost which is equal to

(i) the Minimum Normal Cost; plus

(ii) a 10-year amortization of the unfunded MAL at transition; plus

(iii) a 10-year amortization of each year's increase or decrease in the unamortized unfunded MAL, where the unfunded MAL is equal to the difference between the Minimum Actuarial Liability and the CAS assets net of prepayment credits.

Thus, under this alternative, we impose a "minimum CAS cost" (*i.e.,* item b above) instead of minimum liabilities and normal costs. This will avoid the dramatic changes in CAS assignable costs that occur due to the switching between the regular AAL/NC and MAL/MNC.

Another commenter recommending this approach wrote:

As currently proposed, the MAL adjustment is only applied (or "triggered") when the MAL exceeds the AAL. When this occurs, the AAL is adjusted, as well as the NC. We recommend that in order to reduce cost volatility the Board consider a "cost based" trigger instead. The cost trigger would adjust for the difference between the MAL and AAL, and their associated normal costs, if: [the MAL less AAL amortized over 10 years] plus [the MNC less NC] exceeds $0.

The commenter also was concerned about the effect of inactive segments, writing:

One other issue exists with the proposed liability based MAL trigger. An inequity can result in the application of the requirements at the segment level, especially when a contractor has an inactive segment.

This commenter continues and compares the results of the method proposed in the ANPRM and a "cost based" trigger (identified as Plan 1 and Plan 2) and comments on the results as follows:

The liability trigger results in different costs for Plan 1 and Plan 2 while the cost trigger results in the same cost for both plans. Accordingly, a cost based trigger would treat contractors with and without inactive segments more equitably. In addition, a cost based trigger harmonizes with PPA better than a liability trigger since it is more likely to produce plan level CAS costs closer to PPA minimum contributions.

Regardless of whether a "trigger" approach is used, there was consensus that the comparison should be based on total liability for the period rather than separately testing the actuarial liability (also known as past service liability) and normal cost (incremental liability for the current period). These commenters suggested comparing the sum of the actuarial accrued liability plus the normal cost to the sum of the minimum actuarial liability and the minimum normal cost. One commenter illustrated the problem of comparing the liability and normal cost separately as follows:

The ANPRM proposes, at section 412–40(b)(3)(i), that the actuarial accrued liability (AAL) be adjusted when "the minimum actuarial liability exceeds the actuarial accrued liability." Consider the following example:

	Liability	Normal Cost	Total
AAL assumptions	$100	$10	$110
MAL assumptions	95	20	115

Based on the ANPRM, the MAL assumptions would not be used for this year because the MAL of $95 is less than the AAL of $100. However, because the $115 sum of the MAL and the minimum normal cost exceeds the corresponding amount of $110 on an AAL basis—which thus indicates that the appropriate end-of-year theoretical funding goal should be $115—the Board's intent would seem to be better implemented if the test at 412–40(b)(3)(i) was based upon the liabilities plus the normal costs for the year. This could be accomplished by modifying the relevant language to read: "* * * the minimum actuarial liability *(including minimum normal cost)* exceeds the actuarial accrued liability *(including normal cost).*"

On the other hand, one commenter noted that while a settlement liability is generally inappropriate as a basis for measuring the contract pension cost, such recognition of the settlement liability as a minimum liability is an important element of harmonization and provides better alignment for segment closing measurements.

While I am opposed to a fair value accounting as an accounting basis for the CAS, I also agree with the Board's proposal to subject the liability measurement to a settlement liability minimum.

I agree with this approach primarily because recognizing such a minimum liability measurement will not only achieve harmonization, but will better align the liability measured for period costing with the liability basis for segment closing adjustments and thereby increase predictability. * * *

Another public comment countered, arguing that the proposed ANPRM is based on a "hybrid approach," rather than a "going concern" approach and might not be appropriate given the Board's stated goals.

The proposed revisions to CAS 412 and 413 change the fundamental cost accounting

approach used to measure and assign pension cost. The current CAS 412 and 413 measure and assign pension cost using the "contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations of pension plan performance." The supplementary information in ANPR refers to the current rules as the "going concern approach."

The ANPR retains the "going concern approach" to measure the minimum amount of pension cost for a given accounting period. However, the ANPR requires an adjustment to the "going concern" amounts when either the cost of settling the pension obligation or the PPA minimum funding amount is higher than the "going concern" amount. The ANPR refers to cost of settling the pension obligation as the "settlement or liquidation approach."

The ANPR is therefore a hybrid of these two fundamentally different accounting approaches. As a result, we anticipate that applying the ANPR will both increase the complexity of the contractor's yearly actuarial calculation of pension cost and the amount of pension cost on Government contracts.

Finally, if the minimum actuarial liability is used as a minimum liability basis, two commenters felt that the rule should record changes in basis for the liability (AAL vs. MAL) between years as part of the gain or loss amortization base. Recommending that the change from actuarial accrued liability to the minimum actuarial liability basis and vice-versa as an actuarial loss or gain, respectively, one commenter wrote:

If the measurement basis is modified to reflect current bond rates, we suggest that the rules provide that any change in liability attributable to interest rates will be treated as a gain or loss for cost purposes.

This commenter also suggested that the Board consider adopting the PPA gain and loss approach that adjusts the new unamortized balance and keeps the amortization installment unchanged.

Prior to the PPA, it was standard practice to recalculate amortization payments if there was a change in the applicable interest rate. The PPA introduced a new methodology whereby the amortization amounts remain unchanged, and the difference in the present values is included in a new amortization base established as of the date of the change. For CAS purposes, this difference could be included in the gain and loss base. This method supports the objectives of the CASB because it is easier to apply and reduces the volatility associated with interest rate changes. We therefore recommend that the CAS adopt this approach or allow it as an option without the need for advance approval.

And finally, a commenter asked whether the gain and loss amortization charges reflect the MAL's current settlement interest rate or the long-term return on investment interest rate when the minimum liability applied.

If the MAL applies and the plan is setting up an amortization base for either a plan change or an assumption change, should the amortization base be set up reflecting liabilities on the same basis as the MAL or on the same basis as the regular AAL.

This commenter continued:

If the MAL applies, should amortization charges reflect the long-term interest rate or the MAL interest rate?

Response: The concept of the ANPRM was to recognize the contractor's potential obligation for payment of the settlement liability, which is the PPA funding target, as a minimum in the computation of the assigned cost. Many commenters to the SDP believed that adopting the PPA liability and normal cost would in and of itself provide sufficient harmonization. The amortization of the mandatory prepayment credits (discussed later) was added to the ANPRM to guarantee that the contractor would recover all of its required contributions within a reasonable time period.

As discussed in the ANPRM preamble, the Board continues to believe that contract cost accounting should continue to be based on the going concern basis. The Board also believes that recognition of the full valid liability for the pension plan must consider the risk associated with using the current settlement liability, especially during periods of unusually low corporate bond rates. Therefore, the NPRM retains the minimum actuarial liability as a "floor." The Board observes that during periods of low corporate bond rates the recognition of the minimum actuarial liability and minimum normal cost will harmonize the CAS with the measurement of the PPA minimum required contribution with only a slight lag in recognition due to differences in amortization periods (7 years vs. 10 years). In all other periods, the long-term going concern approach will ensure that annual funding towards the ultimate liability will continue to ensure that sufficient assets are accumulated to protect the participants' benefits.

The Board takes special notice of the comments recommending that the cost not be adjusted if the assigned cost equals or exceeds the PPA minimum required contribution—otherwise the CAS would impose a funding requirement above both the long-term assigned cost computation and ERISA minimum funding contribution. This NPRM proposes the use of a 3-step "trigger," as described under "Recognition of a "minimum actuarial liability" in the summary of the proposed rule. The 3-step trigger uses criteria for recognizing the minimum actuarial liability that is based on a comparison of the assigned pension cost measured on a long-term basis with the ERISA minimum required contribution measured on a settlement basis for a "non-at-risk" plan. If the minimum required contribution exceeds the cost measured by CAS for the period, the minimum liability and minimum normal cost adjustments will be determined, and the contract cost for the period will be re-determined based on the minimum actuarial liability and minimum normal cost. Finally, the pension cost for the period is measured as the greater of the total pension cost measured using the long-term liability and normal cost or the minimum actuarial liability and minimum normal cost.

The Board understands the appeal of recognizing additional contributions made as permitted by IRC Section 436 to improve the funding of a severely underfunded plan. However, the Board disagrees with the suggestion to recognize any additional contribution made to avoid the restrictions imposed by Section 436 of the IRC. The Board believes that recognition of such additional contributions is inappropriate for contract costing purposes because it would increase the volatility of costs between periods, reduce consistency between periods, and lessen comparability between contractors. Predictability would be diminished because the funding level can be affected by sudden changes in asset or liability values. Also, these additional contributions are permitted by the PPA, but are not required. Recognizing these contributions would subject contract costing to the financial management and employee relations decisions of contractors, which is distinctly different from proposing a rule that does not restrict a contractor's financial management decision-making. If the CAS would recognize such additional contributions, it might reduce the disincentive for funding the additional amount and eventually passing the unfunded liability on to the PBGC. However, it is not the purpose of the CAS to protect contractors from choices involving moral hazard.

The preamble to the ANPRM made it clear that the change from actuarial accrued liability to the minimum liability or vice-versa was proposed to be treated as an experience gain or loss, which would be amortized based on the long-term interest rate. For clarity the NPRM explicitly requires that any change in the unfunded actuarial liability due to the minimum actuarial liability be included as part of the actuarial gain or loss measured for the

period and amortized over 10-years based on the long-term interest assumption.

Frequent changes in the interest rates used for amortization purposes would introduce volatility and deviate from the Board objective of cost recognition on a long-term basis. Under the PPA, the gain or loss due to a change in interest rate is captured in the new amortization base and installment. The new installment is measured as the unfunded liability (shortfall) less the present value of the existing amortization installment based on the new interest rate. The rule proposed in this NPRM does not change the way in which amortization installments are measured. The long-term interest rate is used to measure amortization installments and unamortized balances. The Board would be interested in any analysis concerning the increase or reduction of volatility if amortization installment amounts are not changed once established and the effect of any interest rate change measured as an actuarial gain or loss.

Topic G: Computation of Minimum Required Amount.

Many commenters believed that the Minimum Required Amount should be measured without regard for any ERISA prefunding balances. Some commenters presented illustrations of how requiring a reduction to the minimum required amount for the prefunding balance would be inequitable to contractors who believe it is prudent to fund more than the bare minimum.

First, we understand that the intention of the ANPRM approach is to limit the pension costs recovered to the contractors' cash contributions to trusts that have been required to either fund a CAS pension liability or to fund a PPA minimum required contribution for ERISA. Thus, for Government contracting, the cash outlays the contractor has been required to make by PPA are recoverable, while those cash outlays made wholly at the discretion of the contractor are not recoverable until such time as they are no longer discretionary (*e.g.,* they are used to fund CAS pension cost or minimum funding requirements). We believe this approach to limit cost recovery is fair and equitable and support this concept. Fairness and equity might not prevail in some instances if discretionary amounts were immediately recoverable as contractor could influence from one accounting period to the next the amount of pension cost simply by its funding patterns. In addition, we believe this treatment intends to yield consistent cost recovery for contractors with the same funding requirements but different funding patterns over time. However, during our data modeling, we discovered that as currently written, the ANPRM can result in inequitable and inconsistent cost treatment for contractors with the same funding requirements but different funding patterns over time (refer to Illustration 1 in attachment). We believe this to be an unintended consequence that may be corrected with two revisions to the ANPRM.

One commenter believed that the definition proposed at 9904.412.30(a)(18) should include additional contributions for severely underfunded plans.

Additional contributions made to avoid benefit limitations should be treated as a minimum required contribution for purposes of computing mandatory prepayment credits. These contributions are not added to the prefunding balance and may not be used to meet minimum funding requirements for the current year or for any future period. However, they will serve to reduce the minimum required contribution determined for future periods and the mandatory prepayment credits potentially available. Under the proposed standard, special contributions to avoid benefit limitations in excess of the assignable costs will be treated as voluntary prepayments and this may significantly delay reimbursement of those costs. This rule may therefore discourage or penalize contractors with severely underfunded plans from making additional contributions to avoid benefit restrictions.

Response: The Board has reviewed the potential inequities that might arise if the minimum required amount is reduced for prefunding credits. The Board agrees with the commenters and believes that the appropriate comparison for determining when the assigned cost should be adjusted for a minimum liability should be based on comparison of the CAS assigned pension cost to the ERISA minimum required amount before any reduction for CAS prepayments or ERISA prefunding balances, including carry-over balances. This approach is consistent with the Board's desire to allow the contractor latitude in the financial management of its pension plan.

As discussed in the response to the previous topic, the Board believes that recognition of additional contributions made to avoid benefit restrictions are voluntary and could increase volatility. The NPRM does not include recognition of these contributions in the measurement of the minimum required amount.

Topic H: Special Accounting for Mandatory Prepayment Credits.

Comments: Two commenters believed that the special recognition of mandatory prepayment credits creates excess pension expense given other proposed rule harmonization features. One of the commenters believed that the rules relating to mandatory prepayment credits were overly complex and unnecessary.

We recommend that the CAS Board not adopt the proposed provision for annual amortizations of mandatory prepayment credits. We believe that the proposed mandatory prepayment credit provision, which is intended to provide an additional relief for a "negative cash flow" that the contractor may experience in early years, is superfluous and unnecessary, and is difficult to ensure compliance. In our opinion, harmonization of the CAS with the PPA has been achieved sufficiently in the ANPRM that recognizes the PPA liability, reduction in the amortization period for gains and losses, and increase in the assignable cost limitation.

As elaborated below, we believe that the accounting recordkeeping required for the proposed mandatory prepayment credits is unduly complex, burdensome, and unnecessary to achieving harmonization. Current CAS recognizes prepayment credits without distinguishing voluntary from mandatory prepayment credits. Moreover, the proposed creation of a mandatory prepayment account requires separate identification, accumulation, amortization, interest accrual, and other adjustment of mandatory prepayment credits for each year. This process will increase administrative costs, be prone to error, and be very difficult to validate the accuracy and compliance during audit. In our view, harmony with funding differences already exists in the current CAS provision for prepayment credits that will increase in value at the valuation rate of return for funding of future pension costs.

* * * * *

We fully agree with this comment that the ANPRM's recognition of the PPA liability, which is determined by using its required interest rate and mortality assumptions, will substantially close the differences between CAS and PPA cost determinations. All other differences would be minor. Accordingly, we believe that the ANPRM's recognition of the PPA liability alone would accomplish the Congressional mandate for the CAS Board to harmonize the CAS with the PPA. Since the interest rates of corporate bonds are typically less than long-term expected investment rates-of-return of a diversified, bond and equity portfolio as espoused by CAS, the "harmonized" minimum actuarial liability will generally be greater than the CAS-computed actuarial accrued liability. This larger liability will result in a larger unfunded actuarial liability which, in turn, will measure and assign greater pension cost allocable to Government contracts. Recognition of greater pension costs creates greater funding of the pension plan that will provide the funding level required for settling pension obligations under the plan.

Many other commenters advised the Board to revise provisions on amortization of mandatory prepayment credits to simplify the rule and to better coordinate rules for prefunding balances with the PPA. One of these commenters agreed that the proposed rule was too complex and suggested an approach to simplify the accounting for mandatory prepayments:

The proposed rule requires mandatory prepayment charges to be recalculated if the

balance is reduced by an amount in excess of the computed charge. We believe that this requirement is overly complex and prefer an approach that simply reduces the amortization period to reflect any excess payments. The PPA methodology for interest rate changes described in the preceding paragraph should also be permitted for amortization of mandatory prepayment balances. These changes will not only simplify the calculations but also improve the predictability of costs.

There were several comments concerning the interest rate used to update mandatory and voluntary prepayment credits. Most commenters believed that the mandatory and voluntary prepayment accounts should be updated using the same interest rate. They suggested that the rate should be the actual rate of return on assets used to update ERISA prefunding balances. One of the commenters stated:

The proposed CAS 412–50(a)(ii)(B) states that "the value of the voluntary prepayment account shall be adjusted for interest at the actual investment return rate * * *." To avoid possible conflicts, the regulations should more clearly describe how the "actual investment return rate" is to be determined and whether that rate should apply to contributions that generate voluntary prepayment credits during the plan year.

Another one of these commenters opined that the prepayments, once updated based on the actual rate of return, must be subtracted from the market value of assets before measuring the smoothed, actuarial value of the assets. The commenter believed this requirement should be included in the rule and explained:

The rationale for crediting an actual rate of return to prepayment balances is valid. However, if asset smoothing is used, prepayment balances must first be subtracted from plan assets in order to prevent unexpected results. The final standard should therefore specify that asset smoothing is to be applied to the assets after reduction for voluntary prepayment balances. This change in methodology should not require advance approval.

One commenter was particularly concerned with the interest rate used to update the mandatory and voluntary prepayment credits and wrote:

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

A commenter argued that government contractors for whom the percentage of their government contracting business is 90% or greater should be permitted to choose to claim reimbursement of the mandatory prepayment credit immediately when incurred.

We suggest, that for government contractors for whom the percentage of their government contracting business is 90% or greater, that they can choose to claim reimbursement of the mandatory prepayment credit immediately when incurred. Because they derive the vast majority of their income from government reimbursement, we believe that the delayed reimbursement of required cash contributions may create a difficult financing situation for these contractors.

Three commenters asked the Board to clarify that any mandatory prepayment charges are assigned to the period and allocated separately from and in addition to the assignable cost. Two of these commenters believed that the NRPM should not assign and allocate a mandatory prepayment charge in addition to the normally assigned pension cost, especially of the minimum liability concept was retained.

* * * In addition, when comparing the minimum required funding amount under ERISA with the CAS assignable cost for purposes of determining mandatory prepayment credits, it would be helpful to clarify that the CAS assignable cost does not include any mandatory prepayment charges assigned to the period.

Several commenters believed that the proposed record-keeping for mandatory prepayment credits is unduly complex and burdensome. There were many other comments expressing concerns or making detailed recommendations on how to improve or simplify proposed special accounting for mandatory prepayments. These recommendations included suggestions such as converting any voluntary prepayment credits used to fund the PPA minimum contribution to mandatory prepayment credits and establishing a level 5-year payment when the mandatory prepayment is created and maintaining that amount until the mandatory prepayment is fully adjusted.

The public comments also were concerned with the accounting for mandatory prepayment credits at the segment level. As one of these commenters suggested, the rules should be expanded to address how mandatory prepayment charges are apportioned among segments:

Special consideration is required when addressing the treatment of prepayment charges and credits in situations in which a plan maintains more than one segment. The proposed rules suggest that such apportionment is done in a manner similar to how the maximum deductible contribution is allocated. However, this approach does not work very well primarily because the maximum deductible contribution imposes a limit on the otherwise assignable cost, while the prepayment charges represent an addition to the otherwise assignable cost. Furthermore, while the maximum deductible contribution is primarily related to annual costs, the prepayment charges are generated through the underfunding of some segments. Accordingly, we believe that the apportionment of the prepayment charges is more appropriately related to funding levels. While such underfunding is often associated with higher annual costs, there is a much stronger relationship to funding levels.

However, before addressing this further, we think that the CAS Board needs to clarify that the voluntary and the mandatory prepayment accounts be maintained separately and not be apportioned to individual segments. This request is based on our understanding that the intention is for apportioning to occur when these accounts are allocated as part of the assignable cost. The remainder of our comments concerning the distribution of prepayment charges among segments is predicated on this understanding.

Response: The Board agrees with the commenters that the prepayment amortization rules proposed in the ANPRM are unduly complex and burdensome. The Board believes that imposing a settlement-based, minimum liability on the measurement of the pension cost for the period will provide sufficient harmonization with the PPA. The NPRM retains the current recognition of prepayment credits and does not distinguish between mandatory and voluntary prepayments.

The concept presented in the ANPRM was intended to apply the mandatory prepayments as quickly as possible to promote timely recovery of the minimum contributions and lessen the short term cash flow concerns of the contractor. Furthermore, the addition amortization of the mandatory prepayment credits would measure and assign pension cost in excess of that necessary to recognize the normal cost plus amortization of the unfunded actuarial liability.

Amortizing the mandatory prepayment credits essentially achieves a rolling average of the difference between the assigned cost and the contractor's cash contribution. In considering the possible approaches to

harmonization for the NPRM, the Board discussed the possibility of replacing the current cost accrual rules and the proposed recognition of the minimum actuarial liability with some mechanism to smooth the cash contributions over a 3 or 5-year period. However, such an approach would conflict with the Board's goal of basing pension costs on long-term accrual costs and thereby achieve better matching of costs with the activities of an ongoing concern.

This NPRM does not include any provisions to identify or account for mandatory prepayment credits. Nonetheless, the Board appreciates all the suggestions concerning improving the mandatory prepayment provisions.

Topic I: Assignable Cost Limitation (ACL) Requires Modification.

Comments: Most commenters were receptive to the proposal revising the assignable cost limitation and many submitted suggestions concerning clarification of the methodology for calculating the assignable cost limitation.

One commenter believed that the revision of the assignable cost limitation was important for improving predictability for forward pricing.

The impact of the ERISA full funding limitation, and more recently the CAS 412 Assignable Cost Limitation, has presented long-standing predictability problems for forward pricing. I am pleased the Board is addressing this problem, which has always been a predictability problem. This problem was first addressed in the Staff Discussion Paper (SDP) entitled "Fully Funded Pension Plans." 56 FR 41151, August 19, 1991. In that Paper, the staff wrote:

Government contract policymakers also have their own set of special needs, some involving the rhythms peculiar to the pricing of Government contracts, and others involving matters of public policy. It seems obvious, that in the pension area, aggregate pension costs included in prices must reasonably and accurately track accruals for pension costs on the books for Government contract costing purposes. In other words, booked pension costs need to be sufficiently predictable so that forward pricing rates for fixed price contracts are not based upon pension cost levels different from those ultimately accrued for the period of contract performance. That has not been happening in many instances when a fully funded status has been reached unexpectedly. Thus, in a number of instances, where estimated pension costs used for negotiating fixed price contracts include a significant element of pension cost, the subsequent achievement of full funding status served to eliminate pension costs altogether for the period of contract performance.

This commenter continued:

Based on the present ANPRM, the effect of predictability, or the lack thereof, on forward pricing remains a concern to the Board. In response to "#11 Assignable Cost Limitation," the Board explains:

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.

Conversely, another commenter expressed the belief that the 25% buffer was inappropriate and could allow excessive pension costs.

We do not think that the ACL should be raised to 125% of the AAL, plus the normal cost. * * * We are finding that the 125% threshold is unlikely to be reached, which may lead to excessive CAS expense. What happens is that there are no mechanics to wipe out the existing bases. On the other hand, under PPA, a plan is expected to be "fully funded" in 7 years. In reality, under most contractors' investment policy, it would be anticipated that there would be investment gains further reducing the PPA required funding in the long run, while CAS expense continues to grow under the ANPRM model.

Several commenters requested clarification concerning which components of the assignable cost limitation were to be increased by 25%. As one commenter expressed their concern:

Section 9904.412–30(a)(9) defines the Assignable Cost Limitation (ACL) to be "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."

It is unclear whether the 125 percent factor applies only to the AL, or to the Normal Cost and Actuarial Value of Asset as well. In other words, it would be helpful if clarification is provided regarding which of the following the ANPRM intends to be the ACL definition:

(a) 125% x AL, plus NC minus Assets
(b) 125% x (AL plus NC), minus Assets
(c) 125% x (AL plus NC minus Assets)

We believe (b) above is appropriate. The new ACL definition—which reflects the 125% factor—would allow for sufficient surplus assets that would make CAS assignable costs less volatile compared to the current definition.

Some commenters believe that the assignable cost limitation must also recognize the minimum actuarial liability and minimum normal cost to be consistent with computation of the pension cost. Furthermore, harmonization must reflect the settlement liability that is the funding goal of the PPA minimum required contribution.

It is our understanding that multiplying the AAL by 125% in determining the ACL is intended to add a cushion based on long-term funding. We also understand that multiplying the greater of the AAL and the MAL by 125% could, in some situations, result in a cushion that might be inappropriate from a policy perspective. At the same time, however, we feel that it would be inappropriate from a theoretical perspective for the ACL to limit costs in a manner that would preclude full funding on a settlement basis. Accordingly, we recommend that the ACL be calculated using liabilities/normal costs equal to the greater of (a) 125% of the AAL plus 100% of the normal cost and (b) 100% of the MAL plus 100% of the minimum normal cost.

Another commenter explained:

The second area with which we have a concern is the new assignable cost limit (ACL) calculation. While we appreciate the intent of the CAS Board to revise this calculation to reduce the frequency with which plans enter and exit full funding and impact pension costs significantly as a result, we do not believe the ANPRM achieves the desired result nor is aligned with the overarching purpose of this limitation. First, we understand the purpose of the ACL is to prevent an excessive buildup of CAS assets that have funded CAS pension cost. Since pension costs calculated under the ANPRM are based on the greater of the AAL or MAL, it follows that if the ACL is to prevent a buildup of assets that have funded pension costs, it too should consider both the AAL and the MAL. We recognize consideration of the MAL would allow for a higher level of assets, but we believe this is acceptable given that the ANPRM provides for a higher pension cost as well. If the ACL considers only the AAL, as the ANPRM is written, we do not believe that the calculation is aligned with its intended purpose.

We worked with [an actuarial firm] to support us in gathering contractor data estimates to develop a practical assessment of the materiality of the liabilities and normal costs anticipated to consider the effects on ACL results. A total of 13 contractors participated in this survey. Eleven of the survey participants are in the top 100 Department of Defense contractors for 2007. Of the top 100 contractors, many do not have defined benefit pension plans. Based on a data survey (refer to Illustration 3) and modeling by [the actuarial firm], it is the normal cost that will drive the pension cost going forward and accordingly should be more determinative in the ACL calculation to provide for the desired result of reducing the frequency of plans entering and exiting full funding. For these reasons, we recommend revising the calculation of the ACL to include the greater of 125% of the AAL or 100% of the MAL as measured at the end of the year when the respective normal costs would be part of each liability measure. We have provided recommended language for this

revision in the attachment in the section labeled CAS 412–30(a)(9).

Another commenter endorsed the 25% buffer but argued that the assignable cost limitation should not consider the minimum actuarial liability and minimum normal cost. As one commenter expressed their argument:

To limit the amount of the pension cost charged to Government contracts, the ANPRM provides a limitation to the amount of annual pension costs. The limit is "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." We agree with this limitation because it affords some protection against the volatility caused by using the "settlement or liquidation approach."

In response to the ANPRM question as to whether amortization should continue unabated or be deemed fully amortized upon reaching or exceeding the assignable cost limitation, one commenter opined:

The supplementary information with the ANPRM also asked for comments on whether volatility might be better controlled if amortization bases always continue unabated even if the assets exceed the ACL limitation. We believe that allowing the amortization bases to continue unabated could introduce undesirable problems, for example where amortization bases are for negative amounts. We recommend that this concept of unabated bases not be pursued.

Response: The proposed rule does not change the basic definition of the assignable cost limitation and continues to limit the assignable cost to zero if assets exceed the actuarial accrued liability and normal cost. However, under this NPRM the actuarial accrued liability and normal cost shall be revalued as the minimum actuarial liability and minimum normal cost if the proposed criteria of 9904.412–50(b)(7) are met.

The Board shares the commenters' concerns regarding the volatility caused by the abrupt impact of the assignable cost limitation when assets equal or exceed the liability plus the normal cost. While predictability might be improved if pension costs continue to be measured and assigned as the funding level (assets compared to the liability plus normal cost) nears and then rises above and falls below 100%, the Board continues to have concerns with the accumulation of excess assets. Recognition of the minimum actuarial liability and minimum normal cost will decrease the circumstances when a contractor would face having to make a contribution to satisfy ERISA but not have an assignable pension cost for contract accounting purposes. If the assets exceed both the long-term liability and normal cost, and also the minimum actuarial liability and minimum normal cost, then there is no valid cost liability to be funded in the current period.

The Board believes the 10-year minimum amortization period for gains and losses and any liability increase due to the minimum actuarial liability provide sufficient smoothing of costs. Therefore, the NPRM does not include any assignable cost limitation buffer. Under the NPRM, once the revised assignable cost limitation is exceeded, the assigned pension cost continues to be limited to zero.

Topic J: Miscellaneous Topics.

(1) *Comment—Funding Hierarchy:* One commenter recommended that the contributions in excess of the minimum required contribution and voluntary prepayments be eliminated from the proposed "Funding Hierarchy". This commenter wrote:

ANPRM section 412–50(a)(4) contains the following hierarchy of pension funding:

1. Current contributions up to the minimum required funding amount;
2. Mandatory prepayment credits;
3. Voluntary prepayment credits; and
4. Current contributions in excess of the minimum required funding amount.

Although we have no particular concern with this hierarchical approach, and we understand the need for a hierarchy with regard to mandatory prepayment credits, we do have a concern with the required order of items 3. and 4. Specifically, given the lack of explanation in the ANPRM, and past experience at one Government agency, we are concerned that CASB may be attempting to eliminate—with no discussion—quarterly interest adjustments that have long been considered allowable costs on contracts with the DoD and other agencies.

* * * * *

To resolve this problem, we recommend that the funding hierarchy be limited to the first two elements listed above. Alternatively, we recommend that CAS 412 state explicitly that interest based on presumed funding in accordance with the schedule contained in the FAR shall be considered to be a component of pension cost. Under this scenario, however, we note that a number of changes to CAS 412/413 would be required that would be unrelated to harmonization.

Response: The application of current and prior contributions was an important component of the special treatment of mandatory prepayments credits. Since the NPRM does not provide for special treatment of mandatory prepayment credits, the previously proposed funding hierarchy is no longer necessary for the measurement, assignment, and allocation of pension costs. The Board notes that the allowability of pension costs and any associated interest is not addressed by the CAS. Issues of allowability fall within the purview of Part 31 of the Federal Acquisition Regulations (FAR).

(2) *Comment—Future Salary Increases:* One commenter urged the Board to continue recognition of future salary increases in order to promote full costing and to dampen volatility.

I applaud the Board for looking beyond mere coordination with the ERISA minimum required contribution and consideration of the effect of salary projections on the stability of costs across periods. Under #8b—Salary Projections" the Board states:

"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."

Response: The Board has approached harmonization by ensuring that the liability used for contract costing purposes cannot be less than the liability mandated for measuring the minimum required amount. The NPRM does not add any new restrictions on the measurement of the going concern liability. While ERISA and GAAP have moved to settlement interest rates for computing the pension contribution or disclosed expense, both include recognition of established patterns of salary increases for purposes of determining the maximum tax-deductible contribution and the disclosed net periodic pension expense.

(3) *Comment—Cost Increase Due to Assumed Interest Rates:* One commenter expressed their belief that concerns about the increase in contract costs attributable to recognition of a settlement interest rate may be overstated. This commenter notes that the increase in benefits being paid as lump sum settlements has already lessened the difference between the going concern and the settlement liability. This commenter explains as follows:

We concede that market-based bond rates may result in increased costs, but the increases may be less than expected. For plans that pay lump sums based on current bond rates in accordance with § 417(e) of the Internal Revenue Code, the increased costs are probably already reflected to some degree. For plans that pay benefits not based on pay, and for many cash balance plans, costs will likely be determined under the minimum liability provisions of the proposed

rule and will therefore reflect the lower interest rates even if the standard measurement basis is not changed. Finally, we expect that many contractors will move to lower their projected long-term rates of return and will cite the current economic situation as justification for the change. These cost increases will be amortized over as little as 10 years under the proposed rules but can be phased-in more slowly under a transition rule if a change in the measurement basis is mandated.

Response: The Board believes that the current and proposed use of the long-term interest assumption, which is tied to the long-term expected return of the investment portfolio, is the most appropriate rate for contract costing that extends over multiple periods. A best estimate for the going concern approach includes reasonable assumptions regarding the payment of lump sums upon termination or retirement. However, as a matter of CAS harmonization, the use of a settlement rate basis for the limited purpose of determining the minimum actuarial liability and minimum normal cost is permitted and exempted from the general requirement that all assumptions be the contractor's "best estimate" of long-term expectations.

(4) *Comment—Interest Rate and Payment Amount to Amortize the Unfunded Actuarial Liability:* One commenter asked the Board to clarify the interest rate used to amortize the unfunded actuarial liabilities and submitted:

We believe the final rules need to clarify whether the long-term interest rate assumption is to be used to develop all amortization payments, regardless of whether the MAL is higher than the AAL.

Recommendation: We recommend the use of the long-term interest rate assumption in developing all amortization payments. This will simplify the calculations compared to an alternative that would reflect the long-term interest rate assumption in some situations and the MAL interest rate in other situations.

Another commenter was concerned with the re-computation of the amortization installment when interest rates are changed and recommended follows:

The proposed rule requires amortization payments to be based on the assumed long-term rate of return. If the liability measurement basis is changed to reflect current bond rates, the rules should clarify that amortization payments will be calculated based on the effective interest rate. Under ERISA/PPA, liabilities must be discounted using rates that vary by duration, but the plan's actuary is required to determine and disclose the single effective interest rate that will produce an equivalent liability. This rate should be materially consistent with the single discount rate used for FAS purposes. The CAS rule does not need to tie directly to ERISA or FAS, but if the language is properly drafted, it will allow the liabilities and interest rate to be obtained directly from either an ERISA report or a FAS report. Such a rule will also avoid confusion with the PPA rules that require amortization payments to be discounted using the yield curve or segment interest rates.

Response: The NPRM proposes to continue the current requirement to determine a level annual amount based on the prevailing long-term interest assumption and remaining amortization period. The Board notes that potential variances between asset values due to prepayments and asset valuation methods will often mean that the amortization bases and installments shown in a valuation report prepared for ERISA purposes will differ from amortization bases and installments shown in a valuation report prepared for CAS purposes.

(5) *Comment—Trust Expenses as a Component of Minimum Normal Cost:* One commenter requested that the rule specify that trust expenses are part of normal cost based on the amendments made to the PPA by the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA).

The Senate passed H.R. 7327, the Worker, Retiree, and Employer Recovery Act of 2008 on December 11, 2008. The bill was previously passed by the House. It now goes to the President where signature is expected. The Act contains provisions prescribing that pension asset trust expenses be included as part of ERISA target normal costs. These provisions were generically described as "technical corrections" to the Pension Protection Act (PPA). Accordingly we believe the change in treatment of trust expenses to be clearly within the PPA harmonization mandate to the CASB. The implications of this change would be significant for some contractors, exacerbating the negative cash flows that will be experienced by certain contractors.

[We believe] that PPA and CAS should be harmonized by revising the ANPRM to call out trust expenses as a component of CAS normal costs and to specify that reclassification of trust expenses as part of normal costs under both the actuarial accrued liability and minimum actuarial liability bases (versus a reduction to the expected long term interest rate) results in a required change in cost accounting practices whenever necessary to implement the harmonized CAS.

Response: The Board agrees that the minimum required amount should be computed in full accordance with the PPA and its amendments. The Board also believes it is not necessary to make such a specification concerning the long-term cost for CAS purposes. Currently the recognition of plan expenses under CAS is part of the contractor's actuarial assumptions and disclosed cost method. Expenses can be recognized as an increment of normal cost, either as an additional liability or as a decrement to the long-term interest assumption. Additionally, the NPRM specifies that the accumulated value of prepayment credits receives an allocation of administrative expenses in conformity with allocations to segments. The CAS is not in conflict with the PPA and there is no reason to change the current rule.

Administrative expenses can include the payment of investment and trustee fees associated with the investment and management of the assets, *i.e.,* asset-related expenses. Administrative expenses can come from the payment of the PBGC premium and distribution of benefit payments associated with the participants in the plan, *i.e.,* participant-related expenses. The Board is aware that the computation of the pension cost for segments will implicitly or explicitly recognize the estimated administrative expense for the period without distinction between asset investments and participant related expenses. When updating the market value of the assets, an allocation of asset-related expenses across all segments and the accumulated value of prepayment credits matches that expense with the causal/beneficial source of the expense. Allocation of participant-related expenses across all segments including the accumulated value of prepayment credits causes a mismatch of that portion of the expense with the causal/beneficial source of the expense. Conversely not allocating a portion of the asset-related expense to the accumulated value of prepayment credits causes a mismatch in the measurement of the period cost.

The Board believes that the complexity, expense and administrative burden associated with separate identification and allocation of asset-related expenses and participant-related expenses exceed any misallocations in measurement of the period costs, and/or in the allocation of expenses in the updating of asset values. The Board would be interested in any recommendations or analysis regarding the allocation of administrative expenses.

(6) *Comment—Require Use of Projected Unit Credit Actuarial Cost Method:* One commenter recommended that the CAS restrict the choice of actuarial cost method to the projected unit credit (PUC) cost method for the going concern basis of accounting.

The ANPRM notes that responses to the Staff Discussion Paper overwhelmingly support the adoption of a liability basis consistent with ERISA, as amended by the PPA. The Board narrowly interpreted the PPA liability as the amount computed for minimum funding purposes and rejected this

approach because it does not represent the liability for an ongoing plan. We advocate the use of the PUC method, which is required for financial reporting and also for determining the PPA maximum tax deductible limit. The PUC approach reflects projected liabilities (including estimated future salary increases) and is appropriate for an ongoing plan.

The PUC cost method is acceptable under the current and proposed CAS and many contractors are already using this method. Therefore, the discount rate is the only material change required to eliminate the conflict and ensure consistency between the CAS and other pension standards. * * *

Response: The NPRM permits the use of any immediate gain actuarial cost method, including the projected unit credit and therefore does not conflict with ERISA. The Board believes that the contractor should be permitted to use the actuarial cost method and assumptions that best suits its long term financial goals. The Board has not been presented with any risk to the Government or contractor that would demonstrate a need for such a restriction in choice of method.

(7) *Comment—Some Terminology is Inconsistent:* One commenter noted that the normal cost terminology was inconsistent in the ANPRM and advised the Board as follows:

We recommend that the rule define the terms "current normal cost" (used in CAS 412–30 but used in definition of Assignable Cost Limitation), "minimum normal costs" and "normal cost for period."

Response: The Board agrees. The NPRM includes proposed revisions that should ensure all terminology is used consistently throughout CAS 412 and 413.

The major structural difference of the NPRM has been to place most of the harmonization rule into one distinct paragraph at 9904.412–50(b)(7). In this way, the existing measurement, assignment and allocation language can stand unmodified, with some exceptions. If the criteria of 9904.412–50(b)(7) are met, then the user constructively substitutes the minimum actuarial liability value, through an adjustment computation, for the actuarial accrued liability, and the minimum normal cost for the normal cost, and then re-determines the computed, assigned, and allocated costs.

(8) *Comment—Illustrations are Complex:* One commenter opined that the illustrations are complex and suggested using a single reference table of actuarial information.

The illustrations are difficult to evaluate because of the complexity of the rule and the fact patterns of each illustration. We recommend that one reference table be used for the actuarial information covered under one or more illustrations.

Response: The Board agrees. The NPRM includes three examples of the proposed harmonization accounting in a new subsection 9904.412–60.1, Illustrations—CAS Harmonization Rule. The plan facts and actuarial methods and assumptions used for all three harmonization illustrations are described at 9904.412–60.1. These facts disclose that the contractor computes pension costs separately for one segment and on a composite basis for the remaining segments. A pension plan with all segments having an unfunded actuarial liability is the subject of 9904.412–60.1(b), (c) and (d), while a pension plan with one of the segments having an asset surplus is presented in 9904.412–60.1(e), (f) and (g). These two comprehensive examples illustrate the process of measuring, assigning and allocating pension costs for the period. The last illustration, 9904.412–60.1(h), shows how changes over three years between the long-term liability and the settlement liability bases are recognized as actuarial gains or losses.

(9) *Comment—Review the Board's Statement of Objectives, Principles and Concepts:* One commenter suggested that the Board should review and reaffirm its Statement of Objectives, Principles and Concepts.

In conclusion, I recommend that the CAS Board consider revisiting the Board's Statement of Objectives, Policies and Concepts. Part of any such review should include a reaffirmation of predictability as a specific goal or objective of CAS.

Response: The Board believes that while this may be a worthwhile endeavor, such a project would be time consuming and is beyond the scope and timetable for harmonization.

Topic K: Accounting at the Segment Level.

Comment: One commenter suggested that the Board explicitly state how the minimum actuarial liability calculation should be applied in segment accounting, writing:

The ANPRM is not clear regarding the comparison of the regular AAL and MAL under segment accounting: should the comparison be done at a plan level or for each segment individually?

This commenter then continued:

It would be helpful if the final rule is explicit regarding how the MAL should be applied in segment accounting. Otherwise, two contractors might apply the rules differently.

Response: Paragraphs 9904.413–50(c)(3) and (4) require the contractor to measure pension costs separately for a segment or segments whenever there is a difference in demographics, experience, or funding level. A contractor is also permitted to voluntarily compute pension costs on a segment basis. Currently a contractor is required to apply the criteria of 9904.412 to the determination of pension cost for each segment, or aggregation of segments, whenever costs are separately computed. Accordingly, if pension costs are computed at the segment level, under this proposed rule the minimum actuarial liability and minimum normal cost shall be computed at the segment level and the proposed provisions of 9904.412–50(b)(7) shall also be applied at the segment level. If pension costs are permitted to be measured on a composite basis and that is the contractor's established practice, then the minimum actuarial liability and minimum normal cost shall be measured for the plan taken as a whole.

Topic L: CAS 413–50(c)(12) Segment Closing Adjustments.

Comments: One commenter believes that the CAS 413–50(c)(12) segment closing adjustment should be based on the "going concern" liability unless there is an actual settlement. The commenter explained their position as follows:

The CAS 413–50(c)(12) adjusts pension costs when certain non-recurring events occur such as a curtailment of benefits or a segment closing. Though we agree with using the "settlement or liquidation approach" for the measurement of annual pension cost (because of the burden of the added funding requirements of PPA), we believe that the "going concern approach" is the superior method of cost accounting for pension costs and should be generally retained for purposes of computing the CAS 413–50(c)(12) adjustment. We believe that the "going concern approach" provides the best measure of the funds needed by the pension trust to pay pension benefits absent a settlement of the pension obligation. Our experience shows that defense contractors only very rarely settle pension obligations. Therefore, we recommend that the use of the "going concern approach" when a segment has (i) been sold or ownership has been otherwise transferred, (ii) discontinued operations, or (iii) discontinued doing or actively seeking Government business). We note that if the contractor settles the pension obligation due to a segment closing, the current CAS rule permits the use of the "settlement or liquidation approach." Also, we believe that using the "settlement or liquidation approach" for a curtailment of benefits is appropriate since the segment and Government contracts continue.

Three commenters believed that the Board should exempt segment closing adjustments from the five-year phase-in of the minimum liability. They believe that the segment closing adjustment, which is based on the current fair value of assets, should be subject to the current fair value liability for accrued benefits. It has been suggested in other

venues that the absence of such recognition has created a moral hazard wherein contractors purchase annuity contracts or pay lump sums to capture the current value of the liability and pass the increased cost to the Government. Comments included:

The transition rules at ANPRM section 413–64.1(c) provide that the MAL is to be phased-in over five years for segment closing purposes. Given that the premise of segment closing adjustments is that prior-period costs must be trued-up because there are no future periods in which to make adjustments, it does not make sense to us to have a phase-in rule where there is a final settlement. Because this phase-in does not apply to plan terminations, such a rule may encourage contractors to engage in more expensive terminations as a means of avoiding the phase-in. To correct this problem, we recommend that the phase-in be eliminated for segment closing calculations.

The proposed CAS 413–50(c)(12)(i) indicates that the liability used in the determination of a segment closing adjustment shall not be less than the minimum actuarial liability. In addition, the proposed CAS 413–64.1(c) indicates that the minimum actuarial liability is subject to a 5-year phase-in.

We recommend that a segment closing adjustment be determined without regard to the 5-year phase-in. Without this change, a segment closing adjustment can be significantly affected by the exact timing of the event. All other things being equal, other than the timing of the event (*i.e.,* within the 5-year phase-in period versus beyond this period), the ANPRM rules will result in different segment closing adjustments.

The transition rules were put in place 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.” Since the segment closing adjustment represents a one-time event to “true up” CAS assets, it would be unreasonable to subject it to the transition rules and never “true up” the assets to the liability that would have been determined had the event occurred at a later date.

Response: The Board agrees that “the ‘going concern approach’ provides the best measure of the funds needed by the pension trust to pay pension benefits absent a settlement of the pension obligation.” During periods leading up to the segment closing the proposed on-going contract accounting is intended to adequately fund the segment. The settlement liability will serve as a floor to the long-term “going concern” liability. Final accounting (*i.e.,* the true-up of assets and liabilities) when a segment is closed shall be based on the contractor’s decision on how to maintain future funding of the segment, including the contractor’s decision to accept risk of investment in stock equities or to incur the additional expense of transferring the liability. The segment closing provision continues to require that the actuarial accrued liability be based on “actuarial assumptions that are “consistent with the current and prior long term assumptions used in the measurement of pension costs.” The assumptions used to measure the going concern liability may be influenced by modifications to the investment policy for the plan based on changed circumstances (Gould, Inc., ASBCA 46759, Sept. 19, 1997) or a persuasive experience study. This is the same position the Board held when CAS 413 was amended in 1995 when the Board stated in the preamble:

Consistent with the requirement that actuarial assumptions be individual best-estimates of future long-term economic and demographic trends, this final rule requires that the assumptions used to determine the actuarial liability be consistent with the assumptions that have been in use. This is consistent with the fact that the pension plan is continuing even though the segment has closed or the earning of future benefits has been curtailed. The Board does not intend this rule to prevent contractors from using assumptions that have been revised based on a persuasive actuarial experience study or a change in a plan’s investment policy.

Because the segment closing adjustment shall continue to be determined based on the going concern approach, whether the benefit obligation is retained or settled, this NPRM has removed the 5-year phase-in requirement since the 9904.412–50(b)(7) “Harmonization Rule” does not apply to 9904.413–50(c)(12) segment closing adjustments.

Topic M: CAS 413–50(c)(12) Benefit Curtailment Adjustments.

Several commenters believed that the NPRM should eliminate voluntary benefit curtailments from the CAS 413–50(c)(12) required adjustment as long as the segment and contractual relationship continue, *i.e.,* let the curtailment be adjusted as an actuarial gain. These commenters noted that even if there is a complete benefit curtailment, there can be future pension costs due to experience losses. One commenter stated:

Since the CASB is addressing an issue related to plan curtailments, we submit the following suggestion: Revise the proposed rule to also exempt curtailments resulting from voluntary decisions to freeze benefit accruals (in circumstances where the segment is not closed and performance on Government contracts continues) from pension segment closing adjustment requirements. In these instances, gains and losses continue in the plan from demographics, measurement of liabilities and from performance of assets in the trust relative to expectations. Although there are no ongoing normal costs, in order to eliminate risk to both the Government and the contractor, (the contractor) believes these gains and losses should be measured and allocated to final cost objectives in cost accounting periods subsequent to the curtailment.

Another commenter was concerned that retaining the requirement to adjust for a voluntary benefit curtailment might create an incentive to settle the liability and potentially increase the government liability unnecessarily, as follows:

In a case where ERISA would require a cessation of benefit accruals for an “at risk” plan the ANPRM exempts that situation from the segment closing adjustment under CAS 413. We would suggest that CAS Board take this a step further and remove a curtailment of benefits as one of the triggers for a segment closing adjustment. This provision is unnecessary if the contractor is still conducting business with the government. The ongoing calculation of annual assignable cost could easily continue for a pension plan with frozen benefits. Implementing a segment closing adjustment would only provide incentive for the contractor to terminate the frozen plan and settle the pension obligations through annuity purchases and lump sum payments. That would only reduce the amount of any excess assets or increase the amount of any funding shortfall, which would then become an obligation of the government. It would seem to be advantageous to both the government and the contracting companies for the CAS Board to make this change.

One commenter believes that all benefit curtailments should be exempted from adjustment under 9904.413–50(c)(12) as follows:

Under current CAS 413, even if there are ongoing contracts an immediate segment closing adjustment occurs when a contractor freezes its pension plan voluntarily. We note that even when a plan is frozen, there are ongoing CAS costs. We also note that the current CAS 413 is silent as to whether or not ongoing CAS costs can be recognized. Because CAS 413 is silent, it is our understanding that in some situations, contractors are not allowed to further recognize the CAS costs, while there are other situations when such CAS costs are allowed. This results in inequity.

We believe that CAS 413 should be amended to explicitly allow ongoing CAS costs even after a contractor voluntarily freezes its pension plan, if there are ongoing contracts. We note that ongoing CAS costs are allowed under PPA-triggered plan freezes.

Another commenter echoed this request concerning post-curtailment accounting, and asked that if the requirement to make a CAS 413–50(c)(12) adjustment for voluntary benefit curtailments is retained, then the Board should address how to account for subsequent costs and events; *i.e.,* a benefit curtailment followed by a segment closing or plan termination.

The current and revised CAS rules require a CAS 413–50(c)(12) adjustment when

certain events occur such as a divestiture, curtailment of benefits, or pension plan termination. Over the history of a pension plan several events may occur, each requiring its own CAS 413–50(c)(12). Some of the events may impact the pension plan in total such as a curtailment of benefits and termination. To clarify the cost accounting rules, we recommend an illustration be added to show the accounting of a curtailment of benefits followed years later by a termination or when the contractor discontinues doing business with the Government.

Finally, one commenter asked that the Board consider whether the current government agency guidance on accounting for benefit curtailments, "Joint DCMA/DCAA Policy On Defined Benefit Plan Curtailments" dated August 2007, is consistent with the provisions of CAS 413.

Consistent with our earlier recommendation, the Board has provided that any temporary cessations of benefit accruals that may be required by PPA will not be deemed to be "curtailments" under CAS 413. Because curtailments must be revisited in any event to achieve harmonization, we encourage the CASB to abandon the curtailment concept in its entirety, given the ongoing nature of the contractual relationship between the parties. Alternatively, the CASB should consider whether or not current agency guidance, which requires contractors to compute ongoing pension costs under CAS 412/413 for periods following a curtailment, meets the requirements of CAS 413.

Response: The Board believes that the existing CAS 413 curtailment adjustment should be retained except for PPA mandated curtailments for underfunded plans. The 1995 amendments added a $0 floor to the assigned cost, a negative assigned cost would be measured based on the amortization credit for associated actuarial gains, but not assigned and adjusted. This raises a concern that recovery of the potentially large actuarial gain could be indefinitely deferred. This concern was remedied by the CAS 413–50(c)(12) adjustment which permits the Government to recover the surplus either immediately or, if the segment and plan continue, via an amortized contract cost adjustment external to the CAS assigned cost.

For a 9904.413–50(c)(12) adjustment for a benefit curtailment, the liability is adjusted to reflect the benefit curtailment, but the liability is not settled. In this case there is no justification for measuring the liability on a settlement basis. The Board realizes that ability to influence the amount of the benefit curtailment adjustment can provide an incentive for the contractor to consider settling the liability by payment of a lump sum or purchase of an annuity. The Board believes that the Cost Accounting Standards should not constrain the contractor's decisions concerning the financial management that it believes is most appropriate for the pension plan. The contract cost accounting must reflect the cost of the pension plan based on the actual financial management of the plan.

The Board agrees that after a benefit curtailment has occurred and been adjusted, there will continue to be actuarial gains and losses due to demographic and asset experience. To remove disputes concerning the accounting for pension costs and adjustments that are incurred after the benefit curtailment or other segment closing event, the provision proposed at 9904.413–50(c)(12)(ix) provides accounting guidance on the appropriate accounting for the adjustment charge or credit.

The Board does not comment on the administrative guidance issued by individual agencies. Such concerns about the CAS and its administration should be addressed to the Director of the Office of Federal Procurement Policy. The Board notes that agency guidance may have to be revised once this NPRM is issued as a Final Rule.

Topic N: CAS 412 Transition Rules Require Modification.

Comments: Some commenters expressed their concern that the transition rules were lengthy and complex.

As a general rule, we feel that the transition rules require additional thinking, and suggest that the Board carefully consider alternative transition approaches in the time leading up to the publication of a Notice of Proposed Rulemaking (NPRM). In particular, we are concerned that the transition rules are exceedingly complex. In our experience, this level of complexity will inevitably lead to increased disputes and the associated administrative costs. We understand that this is not an easy issue and would be willing to meet with the CASB or staff in an attempt to identify approaches that yield acceptable results to all parties.

One of these commenters remarked that the potential increase in pension costs argued for a longer smoothing period, but also noted that the contractors still had a concern with more immediate cost recovery.

We understand that the lengthy transition rules are intended to provide for smoothing of the substantial increases in pension costs likely to result from the final rules and the backlog of prepayment credits from funding PPA minimum requirements prior to the harmonization. Again, we worked with [an actuary] to gather contractor data estimates to develop a practical measure of the materiality of the increases anticipated to consider whether such an extended and complex transition seemed justified. The same 13 contractors participated in this data survey. The survey considered the effects of mandatory prepayments expected to be amortized under the transition rules and the effects on pension cost of using the higher of the AAL or MAL during the transition period. [The actuary] shared with us our combined data results * * * We believe that considering the data results in the context of the challenging financial conditions likely to affect Government contracting now and in the near future, the lengthy transition rules are generally appropriate. Though from a contractor's perspective more immediate cost recovery of cash outlays made as a result of PPA funding would be desirable, there clearly are other more significant competing considerations.

Gain and loss amortization: Two commenters recommended reducing the current 5-year transition period to 3 years, and two other commenters believed there should be no phase-in for the new 10-year gain/loss amortization rule. Regarding reducing the transition period, one commenter wrote:

[The commenter] believe that the rules providing for a five-year phase-in of certain harmonization provisions result in an undesirable and theoretically problematic shifting of costs from the years when the harmonized CAS 412 and 413 become effective to later years. This results in a bulge in costs in later years that will make programs unaffordable and contractors who continue to maintain defined benefit pension plans uncompetitive. This result is not theoretically sound and importantly has the effect of punishing contractors maintaining defined benefit pension plans, which is contrary to the intent of the PPA. Accordingly, [the commenter] recommends that the CASB shorten the current five-year transition period to three years.

Another commenter noted that given the recent market collapse, the elimination of the transition for gains and losses would result in a favorable impact to contract costing, and recommended:

* * * In particular, we do not see a need to phase-in the reduced amortization period for gains and losses. These costs (or credits) will not emerge until after the effective date of the revised standard. Unless the stock market recovers fairly quickly from its current lows, there may be significant market-related gains emerging during the transition period that could help to offset the increased costs anticipated under the revised rule. A phase-in of the 10-year amortization period will diminish the impact of these potential gains.

One commenter expressed their belief that the benefits of the gain and loss transition were not material, stating as follows:

We support the change from 15 years to 10 years in the amortization period for actuarial gains and losses. However, we do not agree with the 5-year transitional period that gradually reduces the amortization period. There is no advantage to the transitional

period as it only adds unnecessary complexity. If the Board believes that the current 15-year period delays recognition too far beyond the emergence of the gain or loss, and that 10 years is more appropriate, then there should simply be a change made from 15 years to 10 years. We don't believe that the impact on the cost would be material enough to justify adding a transition period for this change.

Legacy prepayments: Many commenters asked that the Board clarify how to make determination of mandatory vs. voluntary prepayment credits. These commenters noted that the legacy voluntary prepayment credits could be simply set equal to the ERISA credit balance. The following comment summarizes the basis for their request:

The proposed CAS 412–64.1(c)(2) indicates that any prepayment credit existing at the transition to the new rules will be deemed to be Voluntary Prepayment Credits (VPC), unless they can be identified as Mandatory Prepayment Credits (MPC).

It may be difficult for contractors to determine the split between the MPC and the VPC at transition, particularly if contributions were made many years ago. The burden will be greatest on contractors who have the longest contractual relationships with the Government. Also, contractors who have undergone merger and acquisition activity will deal with additional complexities. Without any provision specifying how the determination is to be made, how a contractor decides to develop the MPC at transition is potentially an area for dispute between the contractor and the Government.

Recommendation: We recommend a simplified method in determining the VPC and the MPC at transition. Under our proposed method, the VPC account at transition will be the ERISA Credit Balance. The MPC account at transition will be equal to the difference between the Prepayment Credit (as determined under the current CAS rules) and the ERISA Credit Balance (including both Carryover and Prefunding Balances as defined in PPA).

Note that the ERISA Credit Balance reflects the cumulative excess of discretionary contributions over ERISA minimum required contributions. This is akin to the ANPRM's intent of bucketing into the VPC account the contributions in excess of ERISA minimum required contributions, when the ERISA minimum required contributions exceed the CAS assignable costs.

Any remaining Prepayment Credit not categorized as Voluntary Prepayment Credit should thus be in the MPC account. If the Prepayment Credit at transition exceeds the Credit Balance, then that excess would be representative of the aggregate excess of ERISA minimum required contributions over CAS assignable costs, which this ANPRM intends to bucket into the MPC account.

Two commenters believed that the transition accounting for legacy, mandatory prepayment credits is untimely and overly complex and should be replaced with smoother 5-year amortization or a straight 7 to 10-year amortization. One commenter discussed the issue as follows:

We also do not believe that there should be a transitional provision for the amortization period that applies to mandatory prepayment credits. We don't understand the desire to establish a transitional period that roughly matches the typical contracting cycle. It would be more appropriate for the amortization period (as opposed to the transitional period) to roughly match the typical contracting cycle. This would more closely follow the themes of the FAR and CAS that prefer to match cost with the contracts under which that cost arose, and would also more closely follow the goal of harmonization with the PPA. So the amortization period for mandatory prepayment credits should simply be established at 5 years with no transition. If the government has a concern regarding the possible magnitude of legacy prepayment credits that have been created prior to the effective date of the harmonization rule then the government should try to collect some data regarding the amount of those legacy prepayment credits. If such data should demonstrate that the amortization amounts related to the legacy mandatory prepayment credits would impose a difficult financial burden on the government then perhaps a longer amortization period (longer than 5 years) should be established for the legacy mandatory prepayment credits.

Another commenter suggested the proposed tiered 12-year phase-in be maintained, but modified so all amortization ends in year 12, writing:

[The commenter] believes that the proposed transition rule for assigning existing mandatory prepayment credits to cost accounting periods is overly complex. The proposed transition rule divides existing mandatory prepayment credits into multiple increments which are then spread over varying periods of up to twelve years with a deferral of the commencement of the amortization of certain increments for up to four years. In addition to being overly complex and, unnecessarily protracted, the process described in the proposed rule results in an undesirable shifting of costs from earlier periods to the middle periods of the12-year range. This deferral will create an unaffordable burden on program budgets due to the theoretically problematic bulge in costs in the middle years of the proposed 12-year period. [The commenter] believes that the Board could remedy these issues by adopting a shorter overall amortization period of seven to ten years and through utilization of a simple straight line amortization technique.

In contrast, one commenter expressed its belief that transition accounting for legacy, mandatory prepayment credits prior to 2008 is unnecessary and that the special recognition should be limited to the period from 2008 when the PPA became effective until the harmonization rule is applicable.

Finally, the new PPA funding rules went into effect for plan years beginning after 2007 unless a Defense contractor qualifies for an exception pursuant to Section 106, which provides delayed implementation at the earlier of the effective date of the CAS Pension Harmonization Rule or January 1, 2011. Except for certain large Defense contractors that are permitted for delayed implementation, contractors are required to implement the PPA beginning in 2008. Their minimum required contributions under the PPA would likely exceed the CAS assigned cost resulting in "mandatory prepayment credits." To avoid any disparity and attain a fair playing field for all contractors, we recommend recognition of mandatory prepayment credits that are created as a direct result of the implementation of the PPA during the period between 2008 and the effective date of the CAS Harmonization Rule. The method for recognizing these "mandatory prepayment credits" under Government contracts is provided in the Phase-in provision of the ANPRM. We believe that recognition of mandatory prepayment credits as an additional component of assignable pension costs should be limited to these specific circumstances.

Response: In the ANPRM the Board explored several approaches for transition to the harmonization provisions. The Board agrees that the transition provisions of the ANPRM were too complex and that the transition period may have been too long. Many of the transition requirements proposed in the ANPRM have been eliminated from this NPRM. The NPRM only addresses the transition treatment of the change in unfunded liability due to recognition of the minimum actuarial liability.

One of the contracting community's major concerns even prior to the passage of the PPA was the large prepayment credits that had been accumulated because the CAS assigned cost had been less than the ERISA minimum required contribution, especially when the minimum was driven by the additional "deficit reduction contribution" based on the "current liability." The Board understands this concern. Several elements of the proposed harmonization rule will shorten the waiting period for using the prepayment because the allocable contract cost will approximate or exceed the PPA minimum required contribution. Some of these elements include the reduction of plan assets by prepayment credit when measuring the unfunded actuarial liability for CAS purposes, and continuing to base the CAS pension cost on the long-term liability and normal cost in periods when the minimum actuarial liability does not impose a floor liability.

The Board believes that the proposed 10-year amortization of actuarial gains and losses provides adequate smoothing of costs and avoids the build-up of amortization installments. Accordingly,

the NPRM includes no proposal to phase-in the 10-year amortization period which eliminates complexity.

As previously addressed, this NPRM does not provide special recognition of "mandatory prepayment credits" as defined in the ANPRM. As part of the analysis of the proposed provisions of the ANPRM and the public comments, the Board reviewed the requirements of Section 106 of the PPA. Section 106 only addresses harmonization of CAS 412 and 413 with the minimum funding requirement of the PPA. The Board believes that any special recognition of "legacy" mandatory prepayments is beyond the scope of this case.

The Board is concerned with the variance between the required minimum contribution and the allocable cost during the delay of CAS harmonization since PPA became effective in 2008. Assuming that CAS harmonization had been in effect in 2008, the main drivers behind this variance for a pension plan with no CAS prepayment credits and no ERISA prefunding or carry-over balances are (1) the difference in amortization periods for experience gains and losses, and (2) the actuarial loss attributable to using the minimum actuarial liability. The Board did consider providing a remedy for these variances during the delay period. However, the recent extraordinary large asset losses have so magnified the difference between the assigned pension cost and the ERISA minimum contribution that the cost increase for any special recognition is prohibitive and would skew the true cost for the period. Once the initial effects of the market downturn and the initial contribution increase attributable to the PPA have been recognized, the proposed harmonization should bring CAS and ERISA into better alignment while reducing the risk of any unnecessary budget shortfalls for the government contracting agencies.

To manage possible increases in contract costs, the revised draft proposed rule retains a transitional 5-year phase-in, approximating the typical contracting cycle, for any liability adjustment. As proposed, any adjustment to the actuarial accrued liability and normal cost, based on recognition of the minimum actuarial liability and minimum normal cost, 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. 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.

Topic O: Consideration for Effect of Significant Declines in Asset Values Given Extreme Adverse Economic Conditions.

Comment: One commenter was concerned that the amount of prepayments will grow at the assumed long-term rate of interest while the market value of assets declined 30%. This would allow the contractor to unfairly, but unintentionally, gain an out of pocket windfall by permitting an artificially larger prepayment balance to "fund" the pension cost. The commenter noted:

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

Response: The Board appreciates this concern with the potential windfall because the prepayment credits are adjusted with a positive interest rate while the actual assets have declined precipitously. The Board notes that during periods over the last few decades that pension funds have earned returns in excess of the long-term assumption. The net under or over-statement of the accumulated value of prepayments due to the difference in assumed and actual rate of returns over time is difficult to assess. For this reason, and because the Board may only promulgate rules that are prospectively applied, this NPRM does not provide for any special adjustment of the accumulated value of prepayment credits prior to the applicability date of the proposed rule.

Once harmonization becomes applicable, the proposed rule will update the accumulated value of prepayment credits based on an allocable portion of the actual rate of return. This will eliminate the commenter's specific concern once harmonization is in effect.

The exceptional events in the market since late 2008 raise the question as to whether there should be special provisions for the gains and losses attributable to such circumstances. The Board is interested in any comments concerning whether the gain or loss from exceptional events should be amortized over a longer period, *i.e.,* retain the 15-year amortization for such gains and losses. The Board would also appreciate comments on how an exceptional event might be defined or identified.

Topic P: Effective Date and Applicability Date.

Comments: Many commenters asked the Board to revise the effective date of the final rule so as to delay PPA funding requirements until 1/1/2011 for "eligible government contractors" who report on a calendar year basis. The contractors were also concerned that if the harmonization rule was published close to the end of one calendar year they could become subject to it on the first day of the following calendar year without sufficient time to revise their internal cost accounting systems or pricing models. A commenter stated:

> Having a delayed effective date would be a reasonable way of dealing with this problem. Another approach would be to allow contractors to currently update forward pricing even though the final changes to the CAS have not yet been determined. It is unlikely that the Department of Defense would support that approach. Therefore we feel that the CAS Board should clarify that the effective date would not be until 2011.

Several other commenters asked the Board to clarify the effective date of the rule change for existing and new CAS covered contracts. As one of these commenters explained:

> We agree with the ANPRM that the rule should be effective immediately, so that contractors can begin incorporating the effects of the new rule into pricing. We understand that the rule will then become applicable for a contractor in the year following receipt of a new contract or subcontract covered by CAS. We believe the CAS Board intends for the final rule to be applicable to all CAS covered contracts of the contractor after the applicability date not just new contracts, so contractors will be calculating pension costs under only the new CAS rules. However, this is unclear in the ANPRM.

Another commenter asked that the Board consider permitting early

adoption of the new rules subject to Contracting Officer approval, especially if the contractor only had a very limited number of CAS-covered contracts which would not be re-awarded for a delayed period.

The ANPRM states that the new rule will apply to the first cost-accounting period commencing after the later of (i) the date the final rule is published in the **Federal Register**, or (ii) the receipt of a contract or subcontract covered by the CAS. This rule may therefore have a delayed effective date for many CMS contractors who operate under 5-year contracts. Since the new rule is intended to resolve conflicts between the CAS and the PPA, we believe there should be a provision to allow a contractor to adopt early compliance, subject to the approval of the Contracting Officer.

Response: As proposed there are three key dates involved when this rule is published:

1. Date published in the **Federal Register**;

2. Effective Date—Date when contractors must first comply with the new or revised Standard when pricing new contracts or negotiating cost ceilings for new contracts that will be performed after the applicability date; and

3. Applicability Date—Date when the new or revised CAS must be followed by the contractor's cost accounting system for the accumulating, reporting and final settlement of direct costs and indirect rates. This is the first cost accounting period following the receipt of a contract subject to CAS 412 and 413 either through CAS-Coverage or Part 31 of the FAR.

The Board is making every effort to complete this case as quickly as possible. The Board cannot control the publication date for the **Federal Register**, and the Final Rule might be published in 2010. The NPRM proposes to make this rule "effective" as of the date published in the **Federal Register** as a Final Rule.

Once the Final Rule is effective and a contractor accepts the award of a new contract subject to CAS 412 and 413, that contract and any subsequent contracts will be subject to the CAS Harmonization Rule beginning with the next accounting period.

CAS-covered contracts awarded and priced prior to the effective date, that priced or budgeted costs based on the existing CAS, may be eligible for an equitable adjustment in accordance with FAR 52.230–2. This includes contracts awarded on or after the publication date but before the effective date.

To minimize the period between the publication and effective dates, the Board will be closely monitoring the date the Final Rule will be approved and the expected publication date.

The Board believes that the proposed coverage at 9904.412–63.1 and 9904.413–63.1 is consistent with the Board's authorizing statue and past practice. The Board believes that basing the effective and applicability date provisions on any event other than the award of a new contract subject to the provisions of CAS 412 and 413 can cause uncertainty and increase disputes. Therefore, the NPRM does not propose any mechanism for early adoption of the proposed rule. Once the CAS Harmonization Rule is published as a Final Rule, contractors that may not receive a new contract subject to CAS 412 and 413 for several years may request a voluntary change in accounting method and request that the contracting officer consider the change as a desirable change. The contracting officer's decision would be considered under the normal administrative procedure for such requests and would be based on facts and circumstances.

Topic Q: Change in Accounting Practice and Equitable Adjustments.

Comments: One commenter requested clarification that changes to conform to the CAS Harmonization Rule are "Mandatory" Changes that are eligible for Equitable Adjustments.

The response to item 19 in the background and summary of the ANPRM indicates that new rules would be mandatory changes. However, this is not specified in the proposed rules themselves. Recognizing the significant impact of the changes being introduced, we would suggest to ensure that the portions of the new rules, which should be treated as required changes be clearly identified. Accordingly, we ask the CAS Board to consider adding additional language * * * to 9904.412–63(d) and 9904.413–63(d) such as the following suggestion:

All changes to a contractor's cost accounting practices required to comply with the revisions to the Standards in 9904.412 as published [Date published in the Federal Register] shall be treated as required changes in practice as defined under 9903.201–6(a) to be applied to both existing and new contracts.

Two commenters asked that changes to better align their actuarial cost method (cost accounting practice) with the PPA be deemed "desirable" changes, or possibly "mandatory" changes. Changes in actuarial valuation of assets and treatment of expenses as a component of normal cost were given as examples. They are hopeful that all such mandatory and desirable changes could be combined for purposes of measuring the cost impact and negotiating an equitable adjustment.

In our view, there would be significant advantages to both contractors and the Government if contractors were permitted to harmonize their CAS asset smoothing methodology to match their PPA method without that change being deemed a voluntary change in cost accounting practice. This approach would reduce administrative costs by contractors, would simplify future audits and would be consistent with the PPA requirement to harmonize CAS 412/413 with the PPA minimum required contribution. In addition, this would simplify contract and administration with respect to contractors that are considering announcing soon that they intend to modify their asset smoothing formula, effective January 1, 2011, to be the same as their PPA method.

The ANPRM implies that any change in actuarial asset method would be considered as a voluntary change in cost accounting practice, even if a contractor wanted to adopt the same actuarial asset value that is used for calculating ERISA costs under the provisions of the PPA. We feel that such a change should not be considered as a voluntary change in cost accounting practice. The introduction of the MAL will better align the CAS accrued liability with the ERISA liability. If a contractor determines that aligning the actuarial asset value with the ERISA asset value would enhance the objective of achieving harmonization then that specific change should explicitly be allowed.

One commenter asked the Board to clarify that a contractor will continue to have an ability to choose measurement bases and accounting methods, writing as follows:

To minimize disputes, it will be helpful if the rules make clear that in the areas where the contractor has options in how certain items are determined (*e.g.,* MAL interest assumption, actual return on assets, etc.), those items would be considered part of the contractor's CAS accounting policy. Any meaningful changes would be subject to the rules on changes in accounting policy. Because every contractor has their own methodologies and specific issues, general rules that become part of the CAS accounting policy would be preferential to any proscriptive rules. If proscriptive rules were used, contractors would have more certainty around how a particular item should be determined, but odd results could arise depending on the contractor's particular situation.

One commenter asked that plan consolidations made in response to the PPA be treated as a "desirable" change of cost accounting practice.

Because of the increased funding requirements PPA imposes and the sweeping nature of changes to CAS 412 and 413 contemplated by the ANPRM, Northrop Grumman believes the CASB should consider adopting a provision addressing consolidation of plans with disparate practices by expressly providing for desirable change treatment for the impact of consequential changes in cost accounting practices. Such a provision could reasonably provide for tests to ensure the government's interests were not harmed by materially

adverse reallocation of existing trust assets or pension liabilities. We believe this would result in lower administrative expense over time and should in certain circumstances partially mitigate contractors' cash flow issues. Suggested additional language might read as follows:

"Cost accounting practice changes required to implement pension plan realignments and plan consolidations are deemed to be desirable changes if the resulting combination does not materially reduce the government's participation in pension plan assets net of pension plan liabilities."

Another commenter asked if the pension harmonization rule would require a single or multiple equitable adjustments.

The Transition Method at 9904.412.64.1 provides that the adjustment of the actuarial accrued liability, mandatory prepayment credit, and normal cost are phased-in over a 5-year period. This adjustment will require an equitable adjustment when the standard becomes effective. While the equitable adjustment may be measured in year one, the actual adjustment would need to be made in each of the first five years (2011 through 2016). Some may argue that the contracting officer may be required to enter into a series of equitable adjustments for each change to the amortization period. This approach is overly burdensome to the contracting officers and may cause contract disputes. As a result, we recommend that the ANPR add language to clarify this important point, or remove these phase-in rules.

Response: While the NPRM includes changes to or introduction of new elements regarding the measurement, assignment and allocation of pension costs, the proposed amendment of CAS 412 and 413 causes a single change in cost accounting practice. The change is from the existing CAS 412 and 413 bases to the amended CAS 412 and 413 bases. Implementation of the changes and any equitable adjustments that might be required by this single mandatory change are CAS administration processes and are beyond the Board's authority.

Changes not required to be made to conform to the proposed amendments are voluntary changes. The determination of whether such voluntary changes may or may not constitute a desirable change is also a CAS administration matter and dependent upon the facts and circumstances unique to each request.

Some contractors may have changed their asset valuation, recognition of expenses, or other method in response to the PPA prior to the publication of this proposed rule. The Board believes it would be unfair for contractors to be afforded different treatments based on when the change was made. As discussed elsewhere, the Board has only proposed changes necessary to harmonize CAS with the PPA and has avoided limiting or restricting the contractor's ability to adopt cost methods that it believes are most appropriate for the pension plan.

The Board believes that changes in plan design, plan mergers and other such changes are not contract cost accounting changes required by the harmonization rule. Furthermore, some contractors may have made many of these plan design and consolidation changes prior to the harmonization rule's effective date. As with the desirable changes discussed above, it would be unfair to provide different treatment based on when changes on made.

Topic R: Opportunity for Additional Comments.

Comments: Several commenters asked the Board to consider (i) extending the ANPRM comment period, (ii) publishing a second ANPRM for additional public comment or (iii) publish a second NPRM if significant changes are made from ANPRM. One of these commenters acknowledged the short timeframe available to the Board.

Response: The Board published a notice on November 26, 2008 (73 FR 72086) extending the comment deadline to December 3, 2008. Two supplemental comments and one new comment were received. While this NPRM has changed, replaced or eliminated many of the proposed revisions from the ANPRM, these changes are based on comments and recommendation from the public. The NPRM does not introduce any significant new concepts and the Board decided to publish the proposed changes as a proposed rule. The Board has decided to publish the proposed revisions as a NPRM and permit a 60-day comment period for this NPRM. The Board does not anticipate permitting an extension of time to comment upon the NPRM.

Surveys and Modeling Data. The Board continues to 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 contribution and maximum tax-deductible contribution.

D. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this 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 proposed rule are those normally maintained by contractors who claim reimbursement of pension costs under Government contracts.

E. Executive Order 12866 and the Regulatory Flexibility Act

Because most contractors must measure and report their pension liabilities and expenses in order to comply with the requirements of FAS 87 for financial accounting purposes, the economic impact of this proposed rule on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this 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 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 proposed rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980.

F. Public Comments to Notice of Proposed Rulemaking

Interested persons are invited to participate by providing input with respect to this proposed rule for harmonization of CAS 412 and 413 with the PPA. All comments must be in writing, and submitted either electronically via the Federal eRulemaking Portal, e-mail, or facsimile, or via mail as instructed in the **ADDRESSES** section.

As with the ANPRM the Board reminds the public 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 costs 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.

List of Subjects in 48 CFR 9904

Government procurement, Cost Accounting Standards.

Daniel I. Gordon,
Chair, Cost Accounting Standards Board.

For the reasons set forth in this preamble, Chapter 99 of Title 48 of the Code of Federal Regulations is proposed to be amended as set forth below:

PART 9904—COST ACCOUNTING STANDARDS

1. The authority citation for Part 9904 continues to read as follows:

Authority: Pub. L. 100–679, 102 Stat 4056, 41 U.S.C. 422.

2. Section 9904.412–30 is amended by revising paragraphs (a)(1), (9) and (23) to read as follows:

9904.412–30 Definitions.

(a) * * *

(1) *Accrued benefit cost method* means an actuarial cost method under which units of benefits are assigned to each cost accounting period and are valued as they accrue; that is, based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial accrued liability at a plan's measurement date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the Unit Credit cost method without salary projection.)

* * * * *

(9) *Assignable cost limitation* means the excess, if any, of the actuarial accrued liability plus the normal cost for the current period over the actuarial value of the assets of the pension plan.

* * * * *

(23) *Prepayment credit* means the amount funded in excess of the pension cost assigned to a cost accounting period that is carried forward for future recognition. The Accumulated Value of Prepayment Credits means the value, as of the measurement date, of the prepayment credits adjusted for investment returns and administrative expenses and decreased for amounts used to fund pension costs or liabilities, whether assignable or not.

* * * * *

3. Section 9904.412–40 is amended by adding paragraph (b)(3) to read as follows:

9904.412–40 Fundamental requirement.

* * * * *

(b) * * *

(3) For qualified defined benefit pension plans, the measurement of pension costs shall recognize the requirements of 9904.412–50(b)(7) for periods beginning with the "Applicability Date of the Harmonization Rule."

* * * * *

4. In 9904.412–50, paragraphs (a)(1)(v), (2), (4), (b)(5) and (c)(1), (2) and (5) are revised, and paragraph (b)(7) is added to read as follows:

9904.412–50 Techniques for application.

(a) * * *

(1) * * *

(v) Actuarial gains and losses shall be identified separately from unfunded actuarial liabilities that are being amortized pursuant to the provisions of this Standard. The accounting treatment to be afforded to such gains and losses shall be in accordance with Cost Accounting Standard 9904.413. The change in the unfunded actuarial liability attributable to the liability adjustment amount computed in accordance with 9904.412–50(b)(7)(i)(A), including a liability adjustment amount of zero if the provisions of 9904.412–50(b)(7) do not apply for the period, shall be identified and included in the actuarial gain or loss established in accordance with 9904.412–50(a)(1)(v) and 9904.413–50(a)(1) and (2) and amortized accordingly.

* * * * *

(2)(i) Except as provided in 9904.412–50(d)(2), any portion of unfunded actuarial liability attributable to either pension costs applicable to prior years that were specifically unallowable in accordance with the then existing Government contractual provisions, or 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 section.

(ii) Such portions of unfunded actuarial liability shall be adjusted for interest at the assumed rate of interest in accordance with 9904.412–50(b)(4) without regard to 9904.412–50(b)(7). 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).

* * * * *

(4) Any amount funded in excess of the pension cost assigned to a cost accounting period shall be accounted for as a prepayment credit. The accumulated value of such prepayment credits shall be adjusted for investment returns and administrative expenses in accordance with 9904.413–50(c)(7) until applied towards pension cost in a future accounting period. The accumulated value of prepayment credits shall be reduced for portions of the accumulated value of prepayment credits used to fund pension costs or to fund portions of unfunded actuarial liability separately identified and maintained in accordance with 9904.412–50(a)(2). The accumulated value of any prepayment credits shall be excluded from the actuarial value of the assets used to compute pension costs for purposes of this Standard and Cost Accounting Standard 9904.413.

* * * * *

(b) * * *

(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 recognition of historical patterns of benefit improvements under a plan covered by a collectively bargained agreement, the contractor may recognize the same benefit improvements.

* * * * *

(7) "*CAS 412 Harmonization Rule*"*:* For qualified defined benefit pension plans, in any period that the minimum required amount, measured for the plan as a whole, exceeds the pension cost, measured for the plan as a whole and limited in accordance with 9904.412–50(c)(2)(i), then the actuarial accrued liability and normal cost are subject to adjustment in accordance with the provisions of paragraph (b)(7)(i) of this section, and the measured cost shall be adjusted if the criteria of paragraph (b)(7)(ii) of this section are met.

(i) Actuarial accrued liability and normal cost adjustment: In any period that the sum of the minimum actuarial liability plus the minimum normal cost exceeds the sum of the unadjusted actuarial accrued liability plus the unadjusted normal cost, the contractor shall adjust the actuarial accrued liability and normal cost as follows:

(A) The actuarial accrued liability and normal cost determined without regard to this paragraph are the unadjusted actuarial accrued liability and normal cost, respectively:

(B) The liability adjustment amount shall be equal to the minimum actuarial liability, as defined by paragraph (b)(7)(iii)(A) of this section, minus the unadjusted actuarial accrued liability. The liability adjustment amount shall be added to the unadjusted actuarial accrued liability to determine the adjusted actuarial accrued liability. If the liability adjustment amount is a negative amount, that amount shall be subtracted from unadjusted actuarial

accrued liability to determine the adjusted actuarial accrued liability:

(C) The normal cost adjustment amount shall be equal to the minimum normal cost, as defined by paragraph (b)(7)(iii)(B) of this section, minus the unadjusted normal cost. The normal cost adjustment amount shall be added to the unadjusted normal cost to determine the adjusted normal cost. If the normal cost adjustment amount is a negative amount, that amount shall be subtracted from unadjusted normal cost to determine the adjusted normal cost; and

(D) The contractor shall measure and assign the pension cost for the period in accordance with 9904.412 and 9904.413 by using the values of the adjusted actuarial accrued liability and adjusted normal cost as the values of the actuarial accrued liability and normal cost.

(ii) The pension cost for the period shall be the greater of either the pension cost, measured for the period in accordance with paragraph (b)(7)(i) of this section, or the pension cost measured without regard to this paragraph. For purposes of this paragraph (b)(7)(ii), the pension costs measured for the period shall be compared before limiting the cost in accordance with 9904.412–50(c)(2)(ii) and (iii).

(iii) Special definitions to be used for this paragraph:

(A) The *minimum actuarial liability* shall be the actuarial accrued liability measured under the accrued benefit cost method and using an interest rate assumption as described in 9904.412–50(b)(7)(iv).

(B) The *minimum normal cost* shall be measured as the normal cost measured under the accrued benefit cost method and using an interest rate assumption as described in 9904.412–50(b)(7)(iv).

(C) *Minimum required amount* means the contribution required to satisfy the minimum funding requirements of ERISA. For purposes of this paragraph, the minimum required contribution shall not include any additional contribution requirements or elections based upon the plan's ratio of actuarial or market value of assets to the actuarial accrued liabilities measured for ERISA purposes. The minimum required amount shall be measured without regard to any prepayment credits that have been accumulated for ERISA purposes (*i.e.*, prefunding balances).

(iv) Actuarial Assumptions: The actuarial assumptions used to measure the minimum actuarial liability and minimum normal cost shall meet the following criteria:

(A) The interest assumption used to measure the pension cost for the current period shall reflect the contractor's best estimate of rates at which the pension benefits could effectively be settled based on the current period rates of return on investment grade fixed-income investments of similar duration to the pension benefits:

(B) The contractor may elect to use the same rate or set of rates, for investment grade corporate bonds of similar duration to the pension benefits, as published or defined by the Government for ERISA purposes. The contractor's cost accounting practice includes any election to use a specific table or set of such rates and must be consistently followed:

(C) For purposes of this paragraph, use of the current period rates of return on investment grade corporate bonds of similar duration to the pension benefits shall not violate the provisions of 9904.412–40(b)(2) and 9904.412–50(b)(4) regarding the interest rate used to measure the minimum actuarial liability and minimum normal cost: and

(D) 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.

* * * * *

(c) * * *

(1) Amounts funded in excess of the pension cost assigned to 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.

(2) For qualified defined-benefit pension plans, the pension cost measured for a cost accounting period is assigned to that period subject to the following adjustments, in order of application:

(i) Any amount of pension cost measured for the period that is less than zero shall be assigned to future accounting periods as an assignable cost credit. The amount of pension cost assigned to the period shall be zero.

(ii) When the pension cost equals or exceeds the assignable cost limitation:

(A) The amount of pension cost, adjusted pursuant to paragraph (c)(2)(i) of this subsection, shall not exceed the assignable cost limitation,

(B) All amounts described in 9904.412–50(a)(1) and 9904.413–50(a), which are required to be amortized, shall be considered fully amortized, and

(C) Except for portions of unfunded actuarial liability separately identified and maintained in accordance with 9904.412–50(a)(2), any portion of unfunded actuarial liability, which occurs in the first cost accounting period after the pension cost has been limited by the assignable cost limitation, shall be considered an actuarial gain or loss for purposes of this Standard. Such actuarial gain or loss shall exclude any increase or decrease in unfunded actuarial liability resulting from a plan amendment, change in actuarial assumptions, or change in actuarial cost method effected after the pension cost has been limited by the assignable cost limitation.

(iii) Any amount of pension cost of a qualified pension plan, adjusted pursuant to paragraphs (c)(2)(i) and (ii) of this section that exceeds the sum of the maximum tax-deductible amount, determined in accordance with ERISA, and the accumulated value of prepayment credits shall be assigned to future accounting periods as an assignable cost deficit. The amount of pension cost assigned to the current period shall not exceed the sum of the maximum tax-deductible amount plus the accumulated value of prepayment credits.

* * * * *

(5) Any portion of pension cost measured for a cost accounting period and adjusted in accordance with 9904.412–50(c)(2)that exceeds the amount required to be funded pursuant to a waiver granted under the provisions of ERISA shall not be assigned to the current period. Rather, such excess shall be treated as an assignable cost deficit, except that it shall be assigned to future cost accounting periods using the same amortization period as used for ERISA purposes.

* * * * *

5. Section 9904.412–60 is amended by revising paragraphs (b)(2) and (3), (c)(1) through (5), (c)(13), and (d)(4) to read as follows:

9904.412–60 Illustrations.

* * * * *

(b) * * *

(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 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, 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 based on an established pattern of benefit improvements. 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 the established pattern of benefit improvements, 9904.412–50(b)(5) permits the contractor to include the same recognition of expected benefit improvements in computing the pension cost for contract costing purposes. With regard to the second 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).

* * * * *

(c) * * *

(1) Contractor J maintains a qualified defined-benefit pension plan. The actuarial accrued liability for the plan is $20 million and has been adjusted based on the minimum actuarial liability required by 9904.412–50(b)(7). 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. 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 pension cost measured for the total plan exceeds the minimum contribution amount for the period, and therefore the actuarial accrued liability and normal cost were not required to be adjusted in accordance with 9904.412–50(b)(7). 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 following year, 2017, Contractor K computes an unfunded actuarial liability of $4 million. 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 to 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 8% interest, which is the interest assumption for 2015 and 2016, and was brought forward to 2016 in accordance with 9904.412–50(a)(2). Therefore, $216,000 ($200,000 × 1.08) is excluded from the amount considered fully amortized in 2016. The next year, 2017, Contractor K must eliminate $233,280 ($216,000 × 1.08) 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. The accumulated value of prepayment credits is $0. However, because of the ERISA limitation on tax-deductible contributions, Contractor K cannot fund more than $1 million 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 accumulated value of prepayment credits equals $700,000. Therefore, in addition to the $1 million tax-deductible contribution, Contractor K can also apply the $700,000 accumulated value of prepayment credits, which is available for funding as of the first day of the plan year, towards the pension cost computed for the period. 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 computed for the period. A new prepayment credit of $200,000 is created by the excess funding after applying the full $700,000 accumulated value of prepayment credits, plus $800,000 of the $1 million tax deductible contribution, towards the assigned cost of $1.5 million creating a new prepayment credit ($700,000 + $1 million − $1.5 million). The remaining $200,000 prepayment credit is adjusted for $14,460 of investment returns allocated in accordance with 9904.412–50(c)(1) and 9904.413–50(c)(7) and the sum of $214,460 is carried forward until needed in future accounting periods in accordance with 9904.412–50(a)(4).

* * * * *

(13) The assignable pension cost for Contractor O's qualified defined-benefit

plan is $600,000. For the same period, Contractor O contributes $700,000 which is the minimum funding requirement under ERISA. 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 ([$700,000 − $600,000] − $75,000) of excess contribution as a prepayment credit in accordance with 9904.412–50(a)(4).

* * * * *

(d) * * *

(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 prepayment credit. Pursuant to 9904.412–50(a)(4), the $5,000 shall be adjusted for an allocated portion of the total investment earnings and expenses in accordance with 9904.412–50(a)(4) and 9904.413–50(c)(7). The prepayment credit plus allocated earnings and expenses shall be excluded from the actuarial value of assets used to compute the next year's pension cost. The accumulated value of prepayment credits of $5,400 (5,000 × 1.08) may be used to fund the next year's assigned pension cost, if needed.

* * * * *

6. Section 9904.412–60.1 is added to read as follows:

9904.412–60.1 Illustrations—CAS Harmonization Rule.

The following illustrations address the measurement, assignment and allocation of pension cost on or after the Applicability Date of the Harmonization Rule. The first series of illustrations present the measurement, assignment and allocation of pension cost for a contractor with an under-funded segment, followed by another series of illustrations which present the measurement, assignment and allocation of pension cost for a contractor with an over-funded segment. The actuarial gain and loss recognition of changes between the long-term liability and the settlement liability bases are illustrated in 9904.412–60.1(h). The structural format for 9904.412–60.1 differs from the format for 9904.412–60.

(a) *Description of the pension plan, actuarial assumptions and actuarial methods used for 9904.412–60.1 Illustrations.* (1) *Introduction:* Harmony Corporation has a defined-benefit pension plan covering employees at seven segments, all of which have some contracts subject to this Standard and 9904.413. The demographic experience for employees of the Segment 1 is materially different from that of the other six segments so that pursuant to 9904.413–50(c)(2)(iii) the contractor must separately compute the pension cost for Segment 1. Because the factors comprising pension cost for Segments 2 through 7 are relatively equal, the contractor computes pension cost for these six segments on a composite basis. The contractor does not separately account for pension costs related to its inactive employees. The contractor has received its annual actuarial valuation for its qualified defined benefit pension plan, which bases the pension benefit on the employee's final average salary. The plan's Enrolled Actuary has provided the following disclosure concerning the methods (Table 1) and assumptions (Table 2) used to perform the valuation. The Contractor has accepted and adopted these methods and assumptions as its cost accounting practice for this pension plan.

TABLE 1—ACTUARIAL METHODS FOR CAS 412 AND 413 COMPUTATIONS

Valuation date	January 1, 2016
Actuarial Cost Methods:	
CAS 412 & 413 and Tax Deductibility	Projected Unit Credit Cost Method.
Minimum Required Amount	Unit Credit Cost Method without Salary Projection.
Asset Valuation Methods (Actuarial Value of Assets):	
CAS 412 and 413	5–Year delayed recognition of realized and unrealized gains and losses; but within 80% to 120% of Market Value of Assets.
ERISA	24–Month Average Value of Assets but within 90% to 110% of Market Value.

TABLE 2—ACTUARIAL ASSUMPTIONS FOR CAS 412 AND 413 COMPUTATIONS

Long-term expected interest rate:	
Basis	Based on expected long-term return on investment for each class of investment and on the investment mix and policy.
Long-term best-estimate	7.50%
Corporate Bond "Settlement" Rate:	
Basis	24–Month Average 3–Segment Yield Curve as of preceding November 1.
Current Value (Effective Rate)	6.20%
Future Salary Increases	3.00%
Mortality	RP2000 Generational Tables as published by the Secretary of Treasury.
Expense Load on Liability or Normal Cost:	
Long-term liability & Normal Cost	Included as decrement to long-term interest assumption.
Minimum liability & Normal Cost	0.5% of market value of assets added to minimum normal cost.
All other assumptions:	Based on the long-term best estimate of future events. Same set of assumptions is used for ERISA without regard to "At Risk" status.
Change in assumptions since last year:	None.

(2) *Actuarial Methods and Assumptions:* (i) Salary Projections: As permitted by 9904.412–50(b)(5), the contractor includes a projection of future salary increases and uses the projected unit credit cost method, which is an immediate gain actuarial cost method that satisfies the requirements of 9904.412–40(b)(1) for measuring the actuarial accrued liability and normal cost. The unit credit cost method (also known as the accrued benefit cost method) measures the liability for benefits earned prior to and during the current plan year and is also an immediate gain cost method that satisfies 9904.412–40(b)(1) and 50(b)(1).

(ii) Interest Rate:

(A) Long-Term Interest Rate: The contractor's basis for establishing the long-term interest rate assumption satisfies the criteria of 9904.412–40(b)(2) and 9904.412–50(b)(4).

(B) "Settlement" Rate: For purposes of measuring the minimum actuarial liability and minimum normal cost the contractor has elected to use a set of investment grade corporate bond yield rates published by the Secretary of the Treasury. The basis and set of corporate bond rates meet the requirements of 9904.412–50(b)(7)(iv)(A), (B) and (C).

(iii) Mortality: Mortality is based on a table of generational mortality rates published by the Secretary of the Treasury and reflects recent mortality improvements. This table satisfies 9904.412–40(b)(4) which requires assumptions to "represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations." Alternatively, use of the annually updated and published static mortality table would also satisfy this requirement, but in that case the contractor should disclose the source and annual nature of the mortality rate rather than the specific table. The specific table used for each valuation shall be identified.

(iv) Actuarial Value of Assets:

(A) The valuation of the actuarial value of assets used for CAS 412 and 413 is based on a recognized smoothing technique that "provides equivalent recognition of appreciation and depreciation of the market value of the assets of the pension plan." The disclosed method also constrains the asset value to a corridor bounded by 80% to 120% of the market value of assets. This method for measuring the actuarial value of assets satisfies the provisions of 9904.413–50(b)(2).

(B) The Actuarial value of assets used for ERISA purposes limits the expected interest to a specific corporate bond rate regardless of the investment mix and actual expectations. This method fails the criteria of 9904.413–50(b)(2) by not allowing for recognition of potential appreciation. The actuarial value of assets derived under this method cannot be used for CAS 412 and 413 purposes. This actuarial value of assets may be used to determine the minimum required amount since that amount is measured in accordance with ERISA rather than CAS 412 and 413.

(v) An actuarial cost method, as defined at 9904.412–30(a)(4), recognizes current and future administrative expenses. For contract costing purposes, administrative expenses are implicitly recognized as a decrement to the assumed interest rate. Since the published sets of corporate bond rates are not decremented for expenses, the expected expense is explicitly added to the minimum normal cost.

(b) *Underfunded Segment—Measurement of Pension Costs.* Based on the pension plan, actuarial methods and actuarial assumptions described in 9904.412–60.1(a), the Harmony Corporation determines that Segment 1 and Segments 2–7 each have an unfunded actuarial liability and measures its pension cost for plan year 2016 as follows:

(1) *Asset Values:* (i) Market Values of Assets: The contractor adjusts the prior period's market value of assets in accordance with 9904.413–50(c)(7). The accumulated value of prepayment credits are separately identified from the assets allocated to segments and are adjusted in accordance with 9904.412–50(a)(4) and 9904.413–50(c)(7). The adjustment of the market value of assets, including the accumulated value of prepayment credits is summarized in Table 3.

TABLE 3—JANUARY 1, 2016 MARKET VALUE OF ASSETS

	Total plan	Segment 1	Segments 2–7	Accumulated prepayments	Note
Market Value at January 1, 2015	$13,190,000	$1,503,000	$10,633,000	$1,054,000	1
Prepayment Credit Applied		49,000	390,700	(439,700)	1
Contribution	940,080	104,400	835,680		1
Benefit Payments	(864,800)	(80,600)	(784,200)	n/a	1
Investment Earnings	1,068,600	126,341	892,633	49,626	2
Administrative Expenses	(76,000)	(8,986)	(63,485)	(3,529)	3
Market Value at January 1, 2016	14,257,880	1,693,155	11,904,328	660,397	....
Weighted Average Asset Values	13,227,640	1,563,900	11,049,440	614,300	4

Note 1: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.

Note 2: The investment earnings are allocated among segments and the accumulated value of prepayment credits based on average weighted asset values in accordance with 9904.413–50(c)(7) and 9904.412–50(a)(4).

Note 3: The administrative expenses are allocated among segments and the accumulated value of prepayment credits based on average weighted asset values in accordance with 9904.413–50(c)(7) and 9904.412–50(a)(4).

Note 4: The prepayment credits were transferred and applied on the first day of the plan year. The contribution deposit and benefit payments occurred on July 1, 2015. The weighted average asset value for each segment and the accumulated value of prepayment credits was computed by giving 100% weight to the prepayment credit transfer amounts and 50% weighting to the contribution and benefit payments.

(ii) Actuarial Value of Assets: Based on the contractor's disclosed asset valuation method, recognition of the realized and unrealized appreciation and depreciation from the current and four prior periods is delayed and amortized over a 5-year period. The portion of the appreciation and depreciation that is deferred until future periods is subtracted from the market value of assets to determine the actuarial value of assets for CAS 412 and 413 purposes. Table 4 summarizes the determination of the actuarial value of assets by segment as of January 1, 2016.

TABLE 4—JANUARY 1, 2016 ACTUARIAL VALUE OF ASSETS

	Total plan	Segment 1	Segments 2–7	Notes
CAS 413 Actuarial Value of Assets	(Note 1)			
Market Value at January 1, 2016		$1,693,155	$11,904,328	2
Total Deferred Appreciation		(4,398)	(31,400)	3
Unlimited Actuarial Value of Assets		1,688,757	11,872,928	....
CAS 413 Asset Corridor				
80% of Market Value of Assets		1,354,526	9,523,462	....
Market Value at January 1, 2016		1,693,155	11,904,328	2
120% of Market Value of Assets		2,031,788	14,285,194	....
CAS Actuarial Value of Assets	$13,561,685	1,688,757	11,872,928	4

Note 1: Because the actuarial value of assets is determined at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: See Table 3.
Note 3: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.
Note 4: CAS Actuarial Value of Assets cannot be less than 80% of Market Value of Assets or more than 120% of Market Value of Assets.

(2) *Liabilities and Normal Costs:* (i) Long-Term Liabilities and Normal Costs: Based on the plan population data and the disclosed methods and assumptions for CAS 412 ad 413 purposes, the contractor measures the liability and normal cost on a going-concern basis using a long-term interest assumption. The liability and normal cost are shown in Table 5.

TABLE 5—"LONG-TERM" LIABILITIES AS OF JANUARY 1, 2016

	Total plan	Segment 1	Segments 2–7	Notes
Actuarial Accrued Liability	$16,525,000	$2,100,000	$14,425,000	1
Normal Cost	947,700	94,100	853,600	1
Expense Load on Normal Cost	....	....	....	1

Note 1: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.

(ii) Likewise, based on the plan population data and the disclosed methods and assumptions for CAS 412 and 413 purposes, the contractor measures the minimum actuarial liability and minimum normal cost on a "settlement" basis using a set of investment grade corporate bond yield rates published by the Secretary of the Treasury. This measurement is shown in Table 6.

TABLE 6—"SETTLEMENT" LIABILITIES AS OF JANUARY 1, 2016

	Total plan	Segment 1	Segments 2–7	Notes
Minimum Actuarial Liability	$15,557,000	$2,194,000	$13,363,000	1
Minimum Normal Cost	933,700	93,000	840,700	1
Expense Load on Normal Cost	82,000	8,840	73,160	1

Note 1: Information taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation.

(3) *ERISA Contribution Range:* For ERISA purposes, the contractor can deposit any amount that satisfies the minimum contribution requirement and does not exceed the maximum tax deductible contribution amount. The ERISA minimum required and maximum tax-deductible contributions are computed for the plan as a whole. ERISA does not recognize segments or business units.

(i) Funding Shortfall (Surplus):

(A) The contractor computes the funding shortfall (the unfunded actuarial liability for ERISA purposes) as shown in Table 7.

TABLE 7—PPA FUNDING SHORTFALL AS OF JANUARY 1, 2016

	Total plan	Notes
Funding Target	$15,557,000	1
Actuarial Value of Assets for ERISA	(13,469,400)	2
Total Shortfall (Asset Surplus)	2,087,600	....

Note 1: *See* Table 6.
Note 2: Information taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation.

(B) The ERISA actuarial value of assets does not meet the criteria for measuring the actuarial value of assets for CAS purposes. Accordingly, there is a difference of $88,894 between the actuarial value of assets used for ERISA purposes ($13,469,400) and the asset value used for CAS purposes ($13,561,685) as developed in Table 4. However, for purposes of this computation the contractor uses the actuarial value of assets developed for ERISA purposes since this is an ERISA computation.

(ii) Minimum Required Amount: In accordance with 9904.412–50(b)(7)(iii)(C), the minimum required amount is the gross minimum contribution required by ERISA, *i.e.* the minimum required contribution unreduced by any prefunding balances. The contractor can satisfy the ERISA minimum funding requirement by depositing an amount at least equal to the minimum required contribution minus any prefunding balances, subject to certain ERISA restrictions on use of the prefunding balances. This calculation is done at the plan level in accordance with 9904.413–50(c)(7). Table 8 shows the contractor's computation of the minimum required amount (the unreduced minimum required contribution for ERISA purposes) for CAS purposes.

TABLE 8—MINIMUM REQUIRED CONTRIBUTION

	Total plan	Notes
Target Normal Cost	$933,700	1
Expense Load on Target Normal Cost	82,000	1
Shortfall Amortization Amount	576,225	2
Minimum Required Contribution	1,591,925	3
Available Prefunding Balance	(500,000)	4
ERISA Minimum Deposit	1,091,925	5

Note 1: *See* Table 6.
Note 2: Net amortization installment required for the various portions of the Funding Shortfall of $2,087,600 (Table 7) in accordance with ERISA.
Note 3: The ERISA Minimum Required Contribution is the CAS 9904.412–50(b)(7)(iii)(C) "Minimum Required Amount."
Note 4: Information taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation
Note 5: This is the minimum deposit the contractor must make to satisfy ERISA.

(iii) Maximum Tax-Deductible Contribution: In accordance with 9904.412–50(c)(2)(iii), the assigned pension cost may not exceed the ERISA maximum tax-deductible contribution plus any accumulated value of prepayment credits. Presuming the tax-deductible contribution rules have not changed since 2008, the contractor computes the maximum tax-deductible contribution as shown in Table 9.

TABLE 9—TAX-DEDUCTIBLE MAXIMUM

	Total Plan	Notes
Funding Target	$15,557,000	1
Target Normal Cost	933,700	1
Expense Load on Target Normal Cost	82,000	1
PPA Cushion (50% Funding Target)	7,778,500	....
Projected Liability Increment	2,505,000	2
Liability for Deduction Limit	26,856,200	....
Actuarial Value of Assets for ERISA	(13,469,400)	3
Tax-Deductible Maximum	13,386,800	4

Note 1: *See* Table 6.
Note 2: Increase in Funding Target if salaries increases are projected.
Note 3: *See* Table 7.
Note 4: The Tax-Deductible Maximum Contribution cannot be less than the ERISA minimum required contribution developed in Table 8.

(4) *Initial Measurement of Assigned Pension Cost:* Before considering if any adjustments are required by 9904.412–50(b)(7), the contractor must first measure the pension cost for the period based on the actuarial accrued liability and normal cost valued with the long-term interest assumption and the actuarial value of assets.

(i) Measurement of the unfunded actuarial liability: The contractor measures the unfunded actuarial liability in order to compute any portions of unfunded actuarial liability to be amortized in accordance with 9904.412–50(a)(1) and 9904.412–50(a)(2). (Note that the accumulated value of prepayment credits is accounted for separately and is not included in the actuarial value of assets allocated to segments.) See Table 10.

TABLE 10—INITIAL UNFUNDED ACTUARIAL LIABILITY

	Total plan	Segment 1	Segments 2–7	Notes
Actuarial Accrued Liability	$16,525,000	$2,100,000	$14,425,000	1
CAS Actuarial Value of Assets	(13,561,685)	(1,688,757)	(11,872,928)	2
Unfunded Actuarial Liability	2,963,315	411,243	2,552,072	....

Note 1: *See* Table 5.
Note 2: *See* Table 4.

(ii) Measurement of pension cost: The new amortization installment(s) are added to the amortization installments remaining from prior years. The pension cost for the period is measured as the normal cost plus the sum of the amortization installments. Because the long-term interest assumption implicitly recognizes expected administrative expenses, there is no separately identified increment for administrative expenses added to the normal cost. *See* Table 11.

TABLE 11—INITIAL MEASURED PENSION COST

	Total plan	Segment 1	Segments 2–7	Notes
Normal Cost	(Note 1)	$94,100	$853,600	2
Expense Load on Normal Cost				2
Net Amortization Installment		75,387	467,856	3
Measured Pension Cost	$1,490,943	169,487	1,321,456	....

Note 1: Because the pension cost is measured at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 5.
Note 3: Net annual installment required to amortize the portions of unfunded actuarial liability, $411,243 for Segment 1 and $2,552,072 for Segments 2–7, in accordance with 9904.412–50(a)(1).

(5) *Harmonization Tests:* (i) Harmonization Threshold Test:

(A) The pension cost measured for the period is only subject to the adjustments of 9904.412–50(b)(7) if the minimum required amount for the plan exceeds the pension cost, measured for the plan as a whole. See Table 12.

TABLE 12—HARMONIZATION THRESHOLD TEST

	Total plan	Notes
	(Note 1)	
CAS Measured Pension Cost	$1,490,943	2
ERISA Minimum Required Amount	1,591,925	3

Note 1: The ERISA Minimum Required Amount is measured for the Total Plan, therefore the Harmonization Threshold Test is performed for the plan as a whole.
Note 2: *See* Table 11. CAS Measured Cost cannot be less than $0.
Note 3: *See* Table 8. The ERISA minimum required contribution unreduced for any prefunding balance.

(B) In this case, the minimum required amount is larger, and therefore the contractor proceeds to determine whether the pension cost must be adjusted in accordance with 9904.412–50(b)(7). If the minimum required amount had been equal to or less than the assigned pension cost, then the pension cost measured for the period would not be subject to the adjustment provisions of 9904.412–50(b)(7).

(ii)(A) Actuarial Liability and Normal Cost Threshold Test: The contractor compares the sum of the actuarial accrued liability plus normal cost, including any expense load, to the minimum actuarial liability plus minimum normal cost to determine whether the assigned cost for the segment must be adjusted in accordance with 9904.412–50(b)(7)(i). This comparison and determination is separately performed at the segment level in accordance with 9904.413–50(c)(2)(iii). *See* Table 13.

TABLE 13—HARMONIZATION "LIABILITY" TEST

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)	....	....	....
CAS Long-Term Liabilities:				
Actuarial Accrued Liability	....	$2,100,000	$14,425,000	2
Normal Cost	....	94,100	853,600	2
Expense Load on Normal Cost	....	....	....	2, 3
Total Liability for Period	....	2,194,100	15,278,600	....
"Settlement Liabilities":				
Minimum Actuarial Liability	....	2,194,000	13,363,000	4
Minimum Normal Cost	....	93,000	840,700	4
Expense Load on Normal Cost	....	8,840	73,160	4, 5
Total Liability for Period	....	2,295,840	14,276,860	....

Note 1: Because the liability and normal cost used to measure the pension cost is determined at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 5.
Note 3: Because the long-term interest assumption implicitly recognizes expected admin expense there is no explicit amount added to the long-term normal cost.
Note 4: *See* Table 6.
Note 5: For settlement valuation purposes the contractors explicitly identifies the expected expenses as a separate component of normal cost.

(B) As shown in Table 13, the minimum actuarial liability plus minimum normal cost ($2,295,840) exceeds the actuarial accrued liability plus normal cost ($2,194,100) for Segment 1 but not for Segments 2 through 7. Therefore, the contractor must measure the adjusted pension cost for Segment 1 only.

(6) *Measurement of Potentially Adjusted Pension Cost:* To determine whether the pension cost measured for the period must be adjusted in accordance with 9904.412–50(b)(7)(ii), the contractor measures the unfunded actuarial liability, basic pension cost, and the assignable cost limitation by substituting the minimum actuarial liability and minimum normal cost for the actuarial accrued liability and normal cost.

(i) Re-measured Unfunded Actuarial Liability (Table 14):

TABLE 14—RE-MEASURED UNFUNDED ACTUARIAL LIABILITY

	Total plan	Segment 1	Segments 2–7	Notes
Minimum Actuarial Liability	....	$2,194,000	....	1
CAS Actuarial Value of Assets	....	(1,688,757)	....	2
Unfunded Actuarial Liability	....	505,243	....	....

Note 1: *See* Table 6.
Note 2: *See* Table 4.

(ii) Measurement of the Adjusted Pension Cost (Table 15):

TABLE 15—ADJUSTED PENSION COST

	Total plan	Segment 1	Segments 2–7	Notes
Minimum Normal Cost	....	$93,000	....	1
Expense Load on Normal Cost	....	8,840	....	1, 2
Re-measured Amortization Installments	....	88,126	....	3
Adjusted Pension Cost	....	189,966	....	....

Note 1: *See* Table 6.
Note 2: For PPA purposes the contractors explicitly identifies the expected expenses as part of the normal cost.
Note 3: Net amortization installment based on the remeasured unfunded actuarial liability of $505,243 for Segment 1.

(7) *Harmonization of Measured Pension Cost:* For Segment 1 the contractor compares the unadjusted pension cost measured by the unadjusted actuarial accrued liability and normal cost with the adjusted pension cost re-measured by the minimum actuarial liability and minimum normal cost. Because the adjusted pension cost exceeds the unadjusted pension cost, the adjusted pension cost determines the measured pension cost for Segment 1. For Segments 2 through 7 the measured pension cost was not required to be adjusted. *See* Table 16.

TABLE 16—HARMONIZATION TEST

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)	....	....	....
(A) Unadjusted Pension Cost	....	$169,487	$1,321,456	2
(B) Adjusted Pension Cost	....	189,966	n/a	3
Harmonized Pension Cost	1,511,422	189,966	1,321,456	4

Note 1: Because the comparison of the unadjusted and adjusted pension cost is performed separately at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 11.
Note 3: *See* Table 15.
Note 4: Greater of (A) or (B).

(c) *Underfunded Segment—Assignment of Pension Cost.* In 9904.412–60.1(b) the Harmony Corporation measured the total pension cost to be $1,511,422, which is the total of the adjusted pension cost of $189,966 for Segment 1 and the unadjusted pension cost of $1,321,456 for Segments 2 through 7. The contractor must now determine if any of the limitations of 9904.412–50(c)(2) apply.

(1) *Zero Dollar Floor:* The contractor compares the measured pension cost to a zero dollar floor as required by 9904.412–50(c)(2)(i). In this case, the measured pension cost is greater than zero and no assignable cost credit is established. See Table 17.

TABLE 17—CAS 412–50(C)(2)(I) ZERO DOLLAR FLOOR

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)			
Measured Pension Cost ≥ $0		$189,966	$1,321,456	2
Assignable Cost Credit				3

Note 1: Because the provisions of CAS 412–50(2)(i) are applied at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 16. The Measured Pension Cost is the greater of zero or the Harmonized Pension Cost.
Note 3: There is no Assignable Cost Credit since the Harmonized Pension Cost is greater than zero.

(2) *Assignable Cost Limitation:*
(i) As required by 9904.412–50(c)(2)(ii), the contractor measures the assignable cost limitation amount. The pension cost assigned to the period cannot exceed the assignable cost limitation amount. Because the measured pension cost for Segment 1 was adjusted as required by 9904.412–50(b)(7)(ii), the assignable cost limitation for Segment 1 is based on the adjusted values for the actuarial accrued liability and normal cost, including expense load. The unadjusted values of the actuarial accrued liability and normal cost, including expense load, are used to measure the assignable cost limitation for Segment 2 through 7. *See* Table 18.

TABLE 18—CAS 412–50(C)(2)(II) ASSIGNABLE COST LIMITATION

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)			
Actuarial Accrued Liability		$2,194,000	$14,425,000	2
Normal Cost		93,000	853,600	3
Expense Load on Normal Cost		8,840		4
Total Liability for Period		2,295,840	15,278,600	
Actuarial Value of Plan Assets		(1,688,757)	(11,872,928)	5
(A) Assignable Cost Limitation Amount		607,083	3,405,672	6
(B) 412–50(c)(2)(i) Assigned Cost		189,966	1,321,456	7
(C) 412–50(c)(2)(ii) Assigned Cost	1,511,422	189,966	1,321,456	8

Note 1: Because the assignable cost limitation is applied at the segment level when pension costs are separately calculated, no values are shown for the Total Plan.
Note 2: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were met for Segment 1, the Actuarial Accrued Liability has been adjusted to equal the Minimum Actuarial Liability (Table 6). The unadjusted actuarial accrued liability is used for Segments 2–7 (Table 5).
Note 3: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were met for Segment 1, the Normal Cost has been adjusted to equal the Minimum Normal Cost (Table 6). The unadjusted normal cost is used for Segments 2–7 (Table 5).
Note 4: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were met for Segment 1, the Normal Cost is based on the Minimum Normal Cost which explicitly identifies the expected expenses as a separate component of normal cost (Table 6). For Segments 2–7, the expected expenses are implicitly recognized in the measurement of the normal cost (Table 5).
Note 5: *See* Table 4.
Note 6: The Assignable Cost Limitation cannot be less than $0.
Note 7: *See* Table 17.
Note 8: Lesser of lines (A) or (B).

(ii) As shown in Table 18, the contractor determines that the measured pension costs for Segment 1 and Segments 2–7 does not exceed the assignable cost limitation and are not limited.

(3) *Measurement of Tax-Deductible Limitation:*

(i) Finally, after limiting the measured pension cost in accordance with 9904.412–50(c)(2)(i) and (ii), the contractor checks to ensure that the total assigned pension cost will not exceed $14,047,197, which is the sum of the maximum tax-deductible contribution ($13,386,800) as determined in Table 9 plus the accumulated value of prepayment credits ($660,397) shown in Table 3. Since the tax-deductible contribution and prepayments are maintained for the plan as a whole, these values are allocated to segments based on the assignable pension cost after adjustment, if any, for the assignable cost limitation in accordance with 9904.413–50(c)(1)(ii). See Table 19.

TABLE 19—CAS 412–50(C)(2)(III) TAX-DEDUCTIBLE LIMITATION

	Total plan	Segment 1	Segments 2–7	Notes
Maximum Deductible Amount	$13,386,800	$1,682,546	$11,704,254	1, 2
Accumulated Prepayment Credits	660,397	83,003	577,394	3, 4
(A) 412–50(c)(2)(iii) Limitation	14,047,197	1,765,549	12,281,648	
(B) 412–50(c)(2)(ii) Assigned Cost	1,511,422	189,966	1,321,456	5
Assigned Pension Cost	1,511,422	189,966	1,321,456	6

Note 1: Maximum Deductible Amount for the Total Plan is allocated to segments based on the 9904.412–50(c)(2)(ii) Assigned Cost in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.
Note 2: *See* Table 9.

Note 3: Accumulated Prepayment Credits for the Total Plan are allocated to segments based on the 9904.412–50(c)(2)(ii) Assigned Cost in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.
Note 4: *See* Table 3.
Note 5: *See* Table 18.
Note 6: Lesser of lines (A) or (B).

(ii) The assignable pension cost of $1,511,422, measured after considering the assignable cost limitation, does not exceed the 9904.412–50(c)(2)(ii) limit of $14,047,197.

(d) *Underfunded Segment—Allocation of Pension Cost.* In 9904.412–60.1(c) the Harmony Corporation determined that the assigned pension cost for the period was $1,511,422, which is the total of the assigned pension cost of $189,966 for Segment 1 and $1,321,456 for Segments 2 through 7. See Table 19. The contractor determines the amount to be contributed to the funding agency and the allocation of the assigned cost as follows:

(1) *Funding Decision:* (i) The contractor examines several different amounts to contribute to the plan. The contractor must contribute an amount equal to the assigned pension cost of $1,511,422 (Table 19) minus the accumulated value of prepayment credits of $660,397 (Table 3) for the assigned cost to be fully allocable. The minimum contribution amount that must be deposited is determined by segment is shown in Table 20.

TABLE 20—CAS FUNDING REQUIREMENT

	Total plan	Segment 1	Segments 2–7	Notes
CAS Assigned Cost	$1,511,422	$189,966	$1,321,456	1
Accumulated Value of Prepayments	(660,397)	(83,003)	(577,394)	2, 3
CAS Assigned Cost to be Funded	851,025	106,963	744,062	

Note 1: *See* Table 19.
Note 2: *See* Table 3.
Note 3: Accumulated Prepayment Credits for the Total Plan are allocated to segments based on the 9904.412–50(c)(2) Assigned Cost (Table 19) so that the prepayments are proportionally allocated to each segment's assigned pension cost.

(ii) To satisfy the minimum funding requirements of ERISA. The contractor must contribute an amount equal to the minimum required contribution minus any prefunding balances that are permitted to be applied under ERISA. If the pension plan's funding level is below certain ERISA thresholds, then the contractor may also consider including an additional contribution amount to improve the plan's funding level. In this case the plan is sufficiently funded and no additional contribution is needed. See Table 21.

TABLE 21—ERISA FUNDING REQUIREMENT

	Total plan	Notes
Gross Minimum Required Contribution	$1,591,925	1
ERISA Prefunding Credits	(500,000)	1
Net Minimum Required Contribution	1,091,925	
Additional Voluntary Contribution	....	2
ERISA Minimum Deposit	1,091,925	3

Note 1: *See* Table 8.
Note 2: The plan is sufficiently funded and no additional contribution is needed to avoid benefit restrictions.
Note 3: To satisfy ERISA's minimum funding contribution, at least $1,091,925 must be deposited.

(iii) And finally, the contractor's financial management policy for the pension plan is to deposit an amount equal to the cost as determined by the aggregate actuarial cost method so that the liability is liquated in even payments over the years of expected service of the active employees. In this case, the plan's actuary reports that the cost under the aggregate method is $1,254,000.

(iv) Table 22 shows the contractor's determination of the possible range of contributions.

TABLE 22—CONTRIBUTION RANGE

	Total plan	Notes
CAS Assigned Cost to be Funded	$851,025	1
ERISA Minimum Required Deposit	1,091,925	2
Aggregate Method Normal Cost	1,254,000	3
Maximum Tax-Deductible Contribution	13,386,800	4

Note 1: *See* Table 20.
Note 2: *See* Table 21.
Note 3: Information taken directly from the actuarial valuation report prepared for funding policy purposes and supporting documentation.
Note 4: *See* Table 9.

(v) The contractor decides to contribute $1,091,925, which is the net ERISA minimum required contribution (MRC) after deducting any permissible prefunding balances. The contractor applies this required contribution amount toward the CAS assigned pension cost of $1,511,422 (Table 19) and then applies $419,497 ($1,511,422 − $1,091,925 (Table 21)) of the $660,397 (Table 3) accumulated value of prepayment credits to fully fund the CAS assigned pension cost for the period. The $1,091,925 is adjusted for interest and is deposited before the end of the year. The prepayment credit of $419,497 is applied as of the first day of the plan year. The funding of the assigned pension cost by segment is summarized in Table 23:

TABLE 23—FUNDING OF CAS ASSIGNED COST

	Total plan	Segment 1	Segments 2–7	Notes
CAS Assigned Cost	$1,511,422	$189,966	$1,321,456	1
ERISA Minimum Deposit	(1,091,925)	(137,241)	(954,684)	2
Remaining Cost to be Funded	419,497	52,725	366,772	....
Regular Prepayments Credit Applied	(419,497)	(52,725)	(366,772)	3
Remaining CAS Assigned Cost	....	....	....	....
Contribution over Net MRC	....	....	....	4
Unfunded (Prepaid) Cost	....	....	....	5

Note 1: *See* Table 19.
Note 2: The Net Minimum Required Contribution is proportionally allocated to segments based on the Harmonized CAS Assigned Cost that must be funded to be allocable.
Note 3: Before the contractor expends any additional resources, CAS Assigned Cost is funded by application of any available prepayment credits. The prepayment credits are proportionally allocated to segments based on the Remaining Cost to be Funded that must be funded to be allocable in accordance with 9904.413–50(c)(1)(i).
Note 4: The contractor decided not to contribute any funds in excess of the ERISA minimum required contribution reduced by the prefunding balance, if any.
Note 5: When prepayment credits are used to fund the CAS assigned pension cost for the current period, the amount of prepayment credit used will be deducted from the accumulated value of prepayment credits and transferred to segments when the market value of assets are updated for the next valuation. The application of this prepayment credit will appear in the asset roll-up from 1/1/2016 to 1/1/2017.

(2)(i) Since the full $1,511,422 (Table 19) assigned cost is funded, the entire assigned cost can be allocated to intermediate and final cost objectives in accordance with 9904.412–50(d)(1). The pension benefit is determined as a function of salary, and therefore, the salary dollars of plan participants, *i.e.,* covered payroll, is used to allocate the assigned composite pension cost for Segment 2 through 7 (Table 19) among segments. Table 24 summarizes the allocation of assigned pension cost to segment.

TABLE 24—FUNDING OF CAS ASSIGNED COST

	Covered payroll	Segment allocation factor	Allocated pension cost	Notes
Direct Allocation (Segmented Cost):				
(A) Segment 1	$1,127,000	n/a	$189,966	2
Indirect Allocation (Composite Cost)		(Note 1)		
Segment 2	810,000	0.099963	132,097	3
Segment 3	1,621,000	0.200049	264,356	3
Segment 4	2,026,000	0.250031	330,405	3
Segment 5	1,158,000	0.142910	188,849	3
Segment 6	1,247,000	0.153894	203,364	3
Segment 7	1,241,000	0.153153	202,385	3
(B) Subtotal Segments 2–7	8,103,000	1.000000	1,321,456	2
Total Plan (A)+(B)	9,230,000	....	1,511,422	2

Note 1: Allocation factor for segment = segment's covered payroll divided by the total covered payroll for segments 2 though 7, subtotal (B).
Note 2: *See* Table 19.
Note 3: Pension cost for Segments 2–7, subtotal (B), multiplied by allocation factor for the individual segment.

(ii) Once allocated to segments, the assigned pension cost is allocated to intermediate and final cost objectives in accordance with the contractor's disclosed cost accounting practice.

(e) *Overfunded Segment—Measurement of Pension Cost.* Assume the same facts as shown in 9904.412–60.1(b), (c) and (d) for Harmony Corporation except that Segment 1 has an asset surplus, the accumulated value of prepayment credits is $0 and the January 1, 2016 Market Value of Assets is $16,055,092 for the total plan.

(1) *Asset Values:* (i) Table 25 shows the market value of assets held by the Funding Agency.

TABLE 25—FUNDING AGENCY BALANCE AS OF JANUARY 1, 2016

	Total plan	Segment 1	Segments 2–7	Accumulated prepayment	Notes
Market Value at January 1, 2016	$16,055,092	$2,148,712	$13,906,380	....	1

Note 1: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.

(ii) As before, the portion of the appreciation and depreciation that is deferred until future periods is subtracted from the market value of assets to determine the actuarial value of assets for CAS 412 and 413 purposes. The determination of the actuarial value of assets as of January 1, 2016 is summarized in Table 26.

TABLE 26—JANUARY 1, 2016 ACTUARIAL VALUE OF ASSETS

	Total plan	Segment 1	Segments 2—7	Notes
	(Note 1)			
CAS 413 Actuarial Value of Assets:				
Market Value at January 1, 2016	....	$2,148,712	$13,906,380	2
Total Deferred Appreciation	....	(5,700)	(35,200)	3
Unlimited Actuarial Value of Assets	....	2,143,012	13,871,180	....
CAS 413 Asset Corridor:				
80% of Market Value of Assets	....	1,718,970	11,125,104	....
Market Value at January 1, 2016	....	2,148,712	13,906,380	2
120% of Market Value of Assets	....	2,578,454	16,687,656	....
CAS Actuarial Value of Assets	$16,014,192	2,143,012	13,871,180	4

Note 1: Because the actuarial value of assets is determined at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 25.
Note 3: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.
Note 4: CAS Actuarial Value of Assets cannot be less than 80% of Market Value of Assets or more than 120% of Market Value of Assets.

(2) *ERISA Contribution Range:* (i) Funding Shortfall (Surplus): The contractor computes the funding shortfall (the unfunded actuarial liability for ERISA purposes), which in this case is an asset surplus, as shown in Table 27.

TABLE 27—PPA FUNDING SHORTFALL AS OF JANUARY 1, 2016

	Total plan	Notes
Funding Target	$15,557,000	1
Actuarial Value of Assets for ERISA	(16,895,000)	2
Total Shortfall (Surplus)	(1,338,000)	....

Note 1: *See* Table 6.
Note 2: Information taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation.

(ii) Minimum Required Amount: Table 28 shows the contractor computation of the minimum required amount (the unreduced minimum required contribution for ERISA purposes).

TABLE 28—MINIMUM REQUIRED CONTRIBUTION

	Total plan	Notes
Target Normal Cost	$933,700	1
Expense Load on Target Normal Cost	82,000	1
Reduced by Asset Surplus	(1,338,000)	2
Shortfall Amortization Amount	n/a	....
Minimum Required Contribution	....	3
Available Prefunding Balance	n/a	....
ERISA Minimum Deposit	....	4

Note 1: *See* Table 6.
Note 2: See Table 27.
Note 3: The Minimum Required Contribution cannot be less than zero. The ERISA Minimum Required Contribution is the CAS 9904.412–50(b)(7)(iii)(C) "Minimum Required Amount."
Note 4: This is the minimum deposit the contractor must make to satisfy ERISA.

(iii) Maximum Tax-Deductible Contribution: Presuming the tax-deductible contribution rules have not changed since 2008, the contractor computes the maximum tax-deductible contribution as the sum of the funding target, target normal cost, the "cushion" amount and the increase in the funding target for salary projections minus the actuarial value of assets determined for ERISA purposes. The contractor's computation is shown in Table 29.

TABLE 29—TAX-DEDUCTIBLE MAXIMUM

	Total plan	Notes
Funding Target	$15,557,000	1
Target Normal Cost	933,700	1
Expense Load on Target Normal Cost	82,000	1
PPA Cushion (50% Funding Target)	7,778,500	....
Projected Liability Increment	2,505,000	2
Liability for Deduction Limit	26,856,200	....
Actuarial Value of Assets for ERISA	(16,895,000)	3
Tax-Deductible Maximum	9,961,200	....

Note 1: *See* Table 6.
Note 2: Increase in Funding Target if salaries increases are projected.
Note 3: *See* Table 27.

(3) *Initial Measurement of Assigned Pension Cost:* The pension cost is initially measured on the actuarial accrued liability and normal cost, including any expense load, before any adjustments that might be required by 9904.412–50(b)(7)(ii).

(i) Measurement of the unfunded actuarial liability: The contractor measures the unfunded actuarial liability in order to compute any portions of unfunded actuarial liability to be amortized in accordance with 9904.412–50(a)(1) and 9904.412–50(a)(2). See Table 30.

TABLE 30—INITIAL UNFUNDED ACTUARIAL LIABILITY

	Total plan	Segment 1	Segments 2–7	Notes
Actuarial Accrued Liability	$16,525,000	$2,100,000	$14,425,000	1
CAS Actuarial Value of Assets	(16,014,192)	(2,143,012)	(13,871,180)	2
Unfunded Actuarial Liability	510,808	(43,012)	553,820	....

Note 1: *See* Table 5.
Note 2: *See* Table 26.

(ii) Measurement of pension cost: The new amortization installment(s) are added to the amortization installments remaining from prior years. The pension cost for the period is measured as the normal cost plus the sum of the amortization installments. Because the long-term interest assumption implicitly recognizes expected administrative expenses, there is no separately identified increment for administrative expenses added to the normal cost. *See* Table 31.

TABLE 31—INITIAL MEASURED PENSION COST

	Total plan	Segment 1	Segments 2–7	Notes
Normal Cost	(Note 1)	$94,100	$853,600	2
Expense Load on Normal Cost	....	....	....	2
Net Amortization Installment	....	(4,800)	88,700	3
Measured Pension Cost	$1,031,600	89,300	942,300	....

Note 1: Because the pension cost is measured at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 5.
Note 3: Net annual installment required to amortize the portions of unfunded actuarial liability, $(43,012), which is a surplus for Segment 1 and $553,820 for Segments 2–7, in accordance with 9904.412–50(a)(1).

(4) *Harmonization Threshold Test:* (i) The pension cost measured for the period is only subject to the adjustments of 9904.412–50(b)(7) if the minimum required amount for the plan exceeds the pension cost, measured for the plan as a whole. *See* Table 32.

TABLE 32—HARMONIZATION THRESHOLD TEST

	Total plan	Notes
	(Note 1)	

TABLE 32—HARMONIZATION THRESHOLD TEST—Continued

	Total plan	Notes
CAS Measured Pension Cost	$1,031,600	2
ERISA Minimum Required Amount	....	3

Note 1: The ERISA Minimum Required Amount is measured for the Total Plan, therefore the Harmonization Threshold Test is performed for the plan as a whole.
Note 2: *See* Table 31. CAS Measured Cost cannot be less than $0.
Note 3: *See* Table 28. The ERISA minimum required contribution unreduced for any prefunding balance.

(ii) In this case, the CAS measured cost is larger than the minimum required amount for all segments, and therefore the contractor does not need to determine whether the pension cost must be adjusted in accordance with 9904.412–50(b)(7). The contractor can proceed directly to checking the measured pension cost for assignability.

(f) *Overfunded Segment—Assignment of Pension Cost.* In 9904.412–60.1(e) the Harmony Corporation measured the total pension cost to be $1,031,600, which is the sum of the pension cost of $89,300 for Segment 1 and $942,300 for Segments 2 through 7. See Table 31. The contractor must now determine if any of the limitations of 9904.412–50(c)(2) apply.

(1) *Zero Dollar Floor:* The contractor compares the measured pension cost to a zero dollar floor as required by 9904.412–50(c)(2)(i) as shown in Table 33.

TABLE 33—CAS 412–50(c)(2)(i) ZERO DOLLAR FLOOR

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)			
Measured Pension Cost ≥ $0	....	$89,300	$942,300	2
Assignable Cost Credit	....	....	....	3

Note 1: Because the provisions of CAS 412–50(2)(i) are applied at the segment level, no values are shown for the Total Plan except as a summation at the end of the computation.
Note 2: *See* Table 31. The Measured Pension Cost is the greater of zero or the Harmonized Pension Cost.
Note 3: There is no Assignable Cost Credit since the Harmonized Pension Cost is greater than zero.

(2) Assignable Cost Limitation: (i) As required by 9904.412–50(c)(2)(ii), the contractor measures the assignable cost limitation amount. The pension cost assigned to the period cannot exceed the assignable cost limitation amount. Because the measured pension costs for Segment 1 and Segments 2–7 were not subject to adjustment pursuant to 9904.412–50(b)(7)(ii), the assignable cost limitation for Segment 1 and Segments 2–7 are based on the unadjusted values of the actuarial accrued liability and normal cost, including the implicit expense load. *See* Table 34.

TABLE 34—CAS 412–50(c)(2)(ii) ASSIGNABLE COST LIMITATION

	Total plan	Segment 1	Segments 2–7	Notes
	(Note 1)			
Actuarial Accrued Liability	....	$2,100,000	$14,425,000	2, 3
Normal Cost	....	94,100	853,600	3, 4
Expense Load on Normal Cost	....	....	....	3, 5
Total Liability for Period	....	2,194,100	15,278,600	....
Actuarial Value of Plan Assets	....	(2,143,012)	(13,871,180)	6
(A) Assignable Cost Limitation Amount	....	51,088	1,407,420	7
(B) 412–50(c)(2)(i) Assigned Cost	....	89,300	942,300	8
(C) 412–50(c)(2)(ii) Assigned Cost	$993,388	51,088	942,300	9

Note 1: Because the assignable cost limitation is applied at the segment level when pension costs are separately calculated, no values are shown for the Total Plan.
Note 2: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were not met for Segment 1, the Actuarial Accrued Liability has not been adjusted.
Note 3: *See* Table 5.
Note 4: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were not met for Segment 1, the Normal Cost has not been adjusted.
Note 5: Because the criteria of 9904.412–50(b)(7)(i) and (ii) were not met for Segment 1, the Normal Cost is based on the long-term Normal Cost which implicitly identifies the expected expenses within the measurement of the normal cost.
Note 6: *See* Table 26.
Note 7: The Assignable Cost Limitation cannot be less than $0.
Note 8: *See* Table 33.
Note 9: Lesser of (A) or (B). Pension cost for Segment 1 is limited by the Assignable Cost Limitation.

(ii) As shown in Table 34, the contractor determines that the measured pension cost for Segment 1 exceeds the assignable cost limitation and therefore the pension cost for Segment 1 is limited. The measured pension cost for

Segments 2–7 does not exceed the assignable cost limitation and is not limited.

(3) Measurement of Tax-Deductible Limitation: (i) Finally, after limiting the measured pension cost in accordance with 9904.412–50(c)(2)(i) and (ii), the contractor checks to ensure that the assigned pension cost will not exceed the sum of the maximum tax-deductible contribution and the accumulated value of prepayments credits. Since the tax-deductible contribution and prepayments are maintained for the plan as a whole, these values are allocated to segments based on the assignable pension cost after adjustment, if any, for the assignable cost limitation in accordance with 9904.413–50(c)(1)(ii). *See* Table 35.

TABLE 35—CAS 412–50(c)(2)(iii) TAX-DEDUCTIBLE LIMITATION

	Total plan	Segment 1	Segments 2–7	Notes
Maximum Deductible Amount	$9,961,200	$512,311	$9,449,389	1, 2
Accumulated Prepayment Credits				3, 4
(A) 412–50(c)(2)(iii) Limitation	9,961,200	512,311	9,449,389	
(B) 412–50(c)(2)(ii) Assigned Cost	993,388	51,088	942,300	5
Assigned Pension Cost	993,388	51,088	942,300	6

Note 1: Maximum Deductible Amount for the Total Plan is allocated to segments based on (B) 9904.412–50(c)(2)(ii) Assigned Cost in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.
Note 2: *See* Table 29.
Note 3: Accumulated Prepayment Credits for the Total Plan are allocated to segments based on the 9904.412–50(c)(2)(ii) Assigned Cost in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.
Note 4: *See* Table 25.
Note 5: *See* Table 34.
Note 6: Lesser of lines (A) or (B).

(ii) The assignable pension cost of $993,388, measured after considering the assignable cost limitation, does not exceed $9,961,200, which is the sum of the tax-deductible maximum ($9,961,200) plus the accumulated value of prepayment credits ($0), and is therefore fully assignable to the period.

(g) *Overfunded Segment—Allocation of Pension Cost.* In 9904.412–60.1(f) the Harmony Corporation determined that the assigned pension cost for the period was $993,388, which is the total of the assigned pension cost of $51,088 for Segment 1 and $942,300 for Segments 2 through 7. (*See* Table 35.) The contractor must now determine the amount to be contributed to the funding agency and then the allocation of the assigned cost as follows:

(1) *Funding Decision:* (i) The contractor examines several different amounts to contribute to the plan. The contractor must contribute an amount equal to the assigned pension cost minus the accumulated value of prepayment credits for the assigned cost to be fully allocable. *See* Table 36.

TABLE 36—CAS FUNDING REQUIREMENT

	Total plan	Segment 1	Segments 2–7	Notes
CAS Assigned Cost	$993,388	$51,088	$942,300	1
Accumulated Value of Prepayments	0			2, 3
CAS Assigned Cost to be Funded	993,388	51,088	942,300	

Note 1: *See* Table 35.
Note 2: *See* Table 25.
Note 3: Accumulated Prepayment Credits for the Total Plan are allocated to segments based on the 9904.412–50(c)(2) Assigned Cost (Table 19) so that the prepayments are proportionally allocated to each segment's assigned pension cost.

(ii) To satisfy the minimum funding requirements of ERISA the contractor must also contribute an amount equal to the minimum required contribution minus any prefunding balances that are permitted to be applied under ERISA. If the plan's funding level is below certain ERISA thresholds, then the contractor may also consider including an additional contribution amount to improve the plan's funding level. In this case the plan is sufficiently funded and no additional contribution is needed. *See* Table 37.

TABLE 37—ERISA FUNDING REQUIREMENT

	Total plan	Notes
Gross Minimum Required Contribution		1
ERISA Prefunding Credits	n/a	1
Net Minimum Required Contribution		
Additional Voluntary Contribution		2
ERISA Minimum Deposit		3

Note 1: *See* Table 28.
Note 2: The plan is sufficiently funded and no additional contribution is needed to avoid benefit restrictions.
Note 3: No contribution is needed to satisfy ERISA's minimum funding contribution requirements.

(iii) And finally, the contractor's financial management policy for the pension plan is to deposit an amount equal to the cost as determined by the aggregate actuarial cost method so that the liability is liquated in even payments over the years of expected service of the active employees. In this case, the plan's actuary reports that the cost under the aggregate method is $799,000.

(iv) As shown in Table 38, the contractor determines that the possible range of contributions is:

TABLE 38—CONTRIBUTION RANGE

	Total plan	Notes
CAS Assigned Cost to be Funded	$993,388	1
ERISA Minimum Required Deposit	0	2
Aggregate Method Normal Cost	799,000	3
Maximum Tax-Deductible Contribution	9,961,200	4

Note 1: *See* Table 36.
Note 2: *See* Table 28.
Note 3: Information taken directly from the actuarial valuation report prepared for funding policy purposes and supporting documentation.
Note 4: *See* Table 29.

(v) In this case the contractor must deposit $993,388 to fully fund the assigned pension cost so that the full amount is allocable in accordance with 9904.412–50(d)(1). The contractor decides to fund $1,500,000 and build a prepayment credit/prefunding balance reserve that can be used to fund pension costs in future periods. *See* Table 39.

TABLE 39—FUNDING OF CAS ASSIGNED COST

	Total plan	Segment 1	Segments 2–7	Notes
CAS Assigned Cost	$993,388	$51,088	$942,300	1
ERISA Minimum Deposit	....	0	0	2
Remaining Cost to be Funded	993,388	51,088	942,300	
Regular Prepayments Credit Applied	....	....	....	3
Remaining CAS Assigned Cost	993,388	51,088	942,300	
Contribution over Net MRC	(1,500,000)	(51,088)	(942,300)	4
Unfunded (Prepaid) Cost	(506,612)	....	....	5

Note 1: *See* Table 35.
Note 2: *See* Table 28. The Net Minimum Required Contribution is proportionally allocated to segments based on the Harmonized CAS Assigned Cost that must be funded to be allocable.
Note 3: Before the contractor expends any additional resources, CAS Assigned Cost is funded by application of any available prepayment credits. The prepayment credits are proportionally allocated to segments based on the Remaining Cost to be Funded that must be funded to be allocable in accordance with 9904.413–50(c)(1)(i).
Note 4: The contractor decided not to contribute any funds in excess of the ERISA minimum required contribution reduced by the prefunding balance, if any.
Note 5: When prepayment credits are used to fund the CAS assigned pension cost for the current period, the amount of prepayment credit used will be deducted from the accumulated value of prepayment credits and transferred to segments when the market value of assets are updated for the next valuation. The application of this prepayment credit will appear in the asset roll-up from 1/1/2016 to 1/1/2017.

(2)(i) Since the full $993,388 assigned cost is funded, the entire assigned cost can be allocated to intermediate and final cost objectives in accordance with 9904.412–50(d)(1). The allocation of assigned pension cost to segment is summarized in Table 40.

TABLE 40—FUNDING OF CAS ASSIGNED COST

	Covered payroll	Segment allocation factor	Allocated pension cost	Notes
Direct Allocation (Segmented Cost)				
(A) Segment 1	$1,127,000	n/a	$51,088	2
Indirect Allocation (Composite Cost)		(Note 1)		
Segment 2	810,000	0.099963	94,195	3
Segment 3	1,621,000	0.200049	188,506	3
Segment 4	2,026,000	0.250031	235,605	3
Segment 5	1,158,000	0.142910	134,664	3
Segment 6	1,247,000	0.153894	145,014	3
Segment 7	1,241,000	0.153153	144,316	3
(B) Subtotal Segments 2–7	8,103,000	1.000000	942,300	2

TABLE 40—FUNDING OF CAS ASSIGNED COST—Continued

	Covered payroll	Segment allocation factor	Allocated pension cost	Notes
Total Plan (A)+(B)	9,230,000	....	993,388	2

Note 1: Allocation factor for segment = segment's covered payroll divided by the total covered payroll for segments 2 though 7, subtotal (B).
Note 2: *See* Table 36.
Note 3: Pension cost for Segments 2–7, subtotal (B), multiplied by allocation factor for the individual segment.

(ii) Once allocated to segments, the assigned pension cost is allocated to intermediate and final cost objectives in accordance with the contractors disclosed cost accounting practice.

(h) *Actuarial Gain and Loss—Change in Liability Basis.* (1) Assume the same facts shown in 9904.412–60.1(b) for the Harmony Corporation for 2016. The contractor measured the pension cost for 2015 through 2017, in accordance with 9904.412 and 9904.413 before making any adjustments pursuant to 9904.412–50(b)(7) and compared the CAS measured costs to the minimum required amounts for the same period. This comparison is shown in Table 41.

TABLE 41—HARMONIZATION THRESHOLD TEST

	Total plan 2015	Total plan 2016	Total plan 2017	Notes
CAS Measured Pension Cost	$1,426,033	$1,490,943	$1,496,497	1
ERISA Minimum Required Amount	1,266,997	1,591,925	1,386,346	2

Note 1: *See* Table 11 for 2016. CAS Measured Cost cannot be less than $0.
Note 2: *See* Table 8 for 2016. The ERISA minimum required contribution unreduced for any prefunding balance.

(2) Table 42 shows the actuarial liabilities and normal costs, including any expense loads, for 2015 through 2017.

TABLE 42—HARMONIZATION "LIABILITY" TEST

	Segment 1 2015	Segment 1 2016	Segment 1 2017	Notes
CAS Long-Term Liabilities:				
Actuarial Accrued Liability (AAL)	$1,915,000	$2,100,000	$2,305,000	1
Normal Cost (NC)	89,600	94,100	103,200	1
Expense Load on Normal Cost	....	....	....	1, 2
Total Liability for Period	2,004,600	2,194,100	2,408,200	....
"Settlement Liabilities":				
Minimum Actuarial Liability (MAL)	1,901,000	2,194,000	2,312,000	3
Minimum Normal Cost (MNC)	83,800	93,000	100,500	3
Expense Load on Normal Cost	8,300	8,840	9,300	3, 4
Total Liability for Period	1,993,100	2,295,840	2,421,800	....

Note 1: *See* Table 5 for 2016 values.
Note 2: Because the long-term interest assumption implicitly recognizes expected admin expense there is no explicit amount added to the long-term normal cost.
Note 3: *See* Table 6 for 2016 values.
Note 4: For settlement valuation purposes the contractors explicitly identifies the expected expenses as a separate component of normal cost.

(3) For 2015, the unadjusted pension cost measured in accordance with 9904.412 and 9904.413 equals or exceeds the minimum required amount and no adjustment to the actuarial accrued liability and normal cost is required by 9904.412–50(b)(7). For 2016, the minimum required amount does exceed the CAS measured pension cost and the contractor must perform the test required by 9904.412–50(b)(7)(i), and in this case the total settlement liability exceeds the total long-term liability for the period and the actuarial accrued liability and normal cost must be adjusted. This results in an adjusted actuarial accrued liability of $2,194,000, an adjusted normal cost of $93,000 and an adjusted expense load of $8,840. However, for 2017, although the total settlement liability exceeds the total long-term liability for the period, the actuarial accrued liability and normal cost are not adjusted because the unadjusted CAS pension cost equals or exceeds the minimum required amount. Table 43 shows the measurement of the unfunded actuarial liability for 2015 through 2017.

TABLE 43—UNFUNDED ACTUARIAL LIABILITY

	Segment 1 2015	Segment 1 2016	Segment 1 2017	Notes
Current Year Actuarial Liability Basis	AAL	MAL	AAL	
Actuarial Accrued Liability, Including Adjustment	$1,915,000	$2,194,000	$2,305,000	1
Actuarial Value of Assets	(1,500,000)	(1,688,757)	(1,894,486)	2
Unfunded Actuarial Liability (Actual)	415,000	505,243	410,514	....

Note 1: *See* Table 42.
Note 2: The 2016 actuarial value of assets is developed in Table 4.

(4) Except for changes in the value of the settlement interest rate used to measure the minimum actuarial liability and minimum normal cost, there were no changes to the pension plan's actuarial assumptions or actuarial cost methods during the period of 2015 through 2017. The contractor's actuary measured the expected unfunded actuarial liability and determined the actuarial gain or loss for 2016 and 2017 as shown in Table 44.

TABLE 44—MEASUREMENT OF ACTUARIAL GAIN OR LOSS

	Segment 1 2015	Segment 1 2016	Segment 1 2017	Notes
Actual Unfunded Actuarial Liability	(Note 1)	$505,243	$410,514	2
Expected Unfunded Actuarial Liability	....	(381,455)	(448,209)	3
Actuarial Loss (Gain)	....	123,788	(37,695)	....

Note 1: The determination of the actuarial gain or loss that occurred during 2014 and measured on 2015 is outside the scope of this Illustration.
Note 2: *See* Table 43.
Note 3: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.

(5) According to the actuarial valuation report, the 2016 actuarial loss of $123,788 includes a $94,000 actuarial loss ($2,194,000 − $2,100,000) (Table 42) due to a change from a long-term liability to a settlement liability basis, including the effect of any change in the value of the settlement interest rate. As required by 9904.412–50(a)(1)(v), the $94,000 loss due to the change in the liability basis will be amortized as part of the total actuarial loss of $123,788 over ten years in accordance with 9904.413–50(a)(1) and (2). Similarly, the next year's valuation report shows a 2017 actuarial gain of $37,695 includes a $7,000 actuarial gain ($2,305,000 − $2,312,000) due to a change from a settlement liability back to a long-term liability basis, which includes the effect of any change in the value of the settlement interest rate. As required by 9904.412–50(a)(1)(v), the $7,000 gain due the change in the liability basis will be amortized as part of the total $37,695 actuarial gain over ten years in accordance with 9904.413–50(a)(1) and (2).

7. Section 9904.412–63 is revised to read as follows:

9904.412–63 Effective date.

(a) This Standard is effective as of [DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER].

(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 in accordance with paragraph (a) of this section. The date this version of the Standard is first applicable to a contractor's cost accounting period is the "Applicability Date of the Harmonization Rule" for purposes of this Standard.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow the Standard in 9904.412 in effect prior to [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*], until this Standard, effective [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*], becomes applicable following receipt of a contract or subcontract to which this Standard applies.

8. Section 9904.412–64.1 is added to read as follows:

9904.412–64.1 Transition Method for Pension Harmonization.

Contractors that were subject to this Standard prior to [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*] shall recognize the change in cost accounting method over the initial 5-year period of applicability, determined in accordance with 9904.412–63(c), as follows:

(a) Phase-in of the Minimum Actuarial Liability and Minimum Normal Cost Adjustments. The contractor shall recognize on a pro rata basis the actuarial accrued liability and normal cost adjustment amounts measured in accordance with 9904.412–50(b)(7)(i). The actuarial accrued liability and normal cost adjustment amounts shall be multiplied by a percentage based on the year of applicability for this amendment. The percentages are as follows: 20% First Year, 40% Second Year, 60% Third Year, 80% Fourth Year, and 100% thereafter.

(b) Transition illustration. 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 adjusted to $18.8 million ($18 million + [40% × $2 million]) and the normal cost is adjusted to $4.2 million ($4 million + [40% × $0.5 million]).

9. Section 9904.413–30 is amended by revising paragraphs (a)(1) and (16) to read as follows:

9904.413–30 Definitions.

(a) * * *

(1) *Accrued benefit cost method* means an actuarial cost method under which units of benefits are assigned to each cost accounting period and are valued as they accrue; that is, based on the services performed by each employee in the period involved. The measure of normal cost under this method for each cost accounting period is the present value of the units of benefit deemed to be credited to employees for service in that period. The measure of the actuarial accrued liability at a plan's measurement date is the present value of the units of benefit credited to employees for service prior to that date. (This method is also known as the Unit Credit cost method without salary projection.)

* * * * *

(16) *Prepayment credit* means the amount funded in excess of the pension cost assigned to a cost accounting period that is carried forward for future recognition. The Accumulated Value of Prepayment Credits means the value, as of the measurement date, of the prepayment credits adjusted for investment returns and administrative expenses and decreased for amounts used to fund pension costs or liabilities, whether assignable or not.

* * * * *

10. Section 9904.413–40 is amended by revising paragraph (c) to read as follows:

9904.413–40 Fundamental requirement.

* * * * *

(c) *Allocation of pension cost to segments.* 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, actuarial accrued liability and normal cost 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, for the plan as a whole and apportioned among the segment(s), shall not exceed the sum of

(1) The maximum tax-deductible amount computed, plus

(2) The accumulated value of prepayment credits.

11. Section 9904.413–50 is amended by revising paragraphs (a)(2), (c)(1)(i) and (c)(7) and adding paragraphs (b)(6) and (c)(12)(viii) and (ix) to read as follows:

9904.413–50 Techniques for application.

(a) * * *

(2) For periods beginning prior to the "Applicability Date of the Harmonization Rule," 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 15-year period in equal annual installments, beginning with the date as of which the actuarial valuation is made. For periods beginning on or after the "Applicability Date of the Harmonization Rule," such actuarial gains and losses 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) * * *

(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 present value of such receivable contributions shall be measured in accordance with ERISA

(iii) The market value of plan assets measured in accordance with paragraphs (b)(6)(i) or (ii) of this section shall be the basis for measuring the actuarial value of plan assets in accordance with this Standard.

* * * * *

(c) * * *

(1) * * *

(i) When apportioning to segments the sum of (A) 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 (B) the accumulated value of the prepayment credits, the contractor shall use a base that considers the otherwise assignable pension costs or the funding levels of the individual segments.

* * * * *

(7) After the initial allocation of assets, the contractor shall maintain a record of the portion of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to the segment and paid from the assets of the pension plan. Income (investment returns) shall include a portion of any investment gains and losses attributable to the assets of the pension plan. Income and expenses of the pension plan assets shall be allocated to the segment in the same proportion that the average value of assets allocated to the segment bears to the average value of total pension plan assets, including the accumulated value of prepayment credits, for the period for which income and expenses are being allocated.

* * * * *

(12) * * *

(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.

(ix) Once determined, any adjustment credit shall be first used to reduce the accumulated value of permitted unfunded accruals. After the accumulated value of permitted unfunded accruals has been fully reduced, any remaining adjustment amount shall be accounted for as a prepayment credit. Any adjustment charge shall be accounted for as a permitted unfunded accrual to the extent that funds are not added to the fair value of assets. All unamortized balances maintained in accordance with 9904.412–50(a)(1) and 9904.413–

50(a)(1) and (2) shall be deemed immediately recognized and eliminated as part of the adjustment charge or credit. If the segment no longer exists, the accumulated value of prepayment credits, the accumulated value of permitted unfunded accruals and the balance separately identified under 9904.412–50(a)(2) shall be transferred to the former segment's immediate home office.

12. Section 9904.413–60 is amended by revising paragraphs (a) and (c)(12) and adding paragraphs (b)(3) and (c)(26) to read as follows:

9904.413–60 Illustrations.

(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 and any actuarial gains or losses measured must be separately amortized over a specific period of years beginning with the period for which the actuarial valuation is made in accordance with 9904.413–50(a)(1) and (2). If the actuarial gain or loss is measured for a period beginning prior to the "Applicability Date for the Harmonization Rule," the gain or loss shall be amortized over fifteen years. For gains and losses measured for periods beginning on or after the "Applicability Date for the Harmonization Rule," the gain or loss shall be amortized over ten years.

* * * * *

(b) * * *

(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.

(c) * * *

(12) Contractor M sells its only Government segment. Through a contract novation, the buyer assumes responsibility for performance of the segment's Government contracts. Just prior to the sale, the actuarial accrued liability under the actuarial cost method in use is $18 million and the market value of assets allocated to the segment is $22 million. In accordance with the sales agreement, Contractor M is required to transfer $20 million of assets to the new plan. In determining the segment closing adjustment under 9904.413–(50)(c)(12) the actuarial accrued liability and the market value of assets are reduced by the amounts transferred to the buyer by the sale. The adjustment amount, which is the difference between the remaining assets ($2 million) and the remaining actuarial liability ($0), is $2 million.

* * * * *

(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).

13. Section 9904.413–63 is revised to read as follows:

9904.413–63 Effective date

(a) This Standard is effective as of [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*].

(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 in accordance with paragraph (a) of this section. The date this version of the Standard is first applicable to a contractor's cost accounting period is the "Applicability Date of the Harmonization Rule" for purposes of this Standard.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow the Standard in 9904.413 in effect prior to [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*], until this Standard, effective [*DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER*], becomes applicable following receipt of a contract or subcontract to which this Standard applies.

14. Section 9904.413–64.1 is added to read as follows:

9904.413–64.1 Transition Method for Pension Harmonization.

See 9904.412.64.1 Transition Method for Pension Harmonization.

[FR Doc. 2010–9783 Filed 5–7–10; 8:45 am]

BILLING CODE P