

The Pension Protection Act: the Cost Accounting Standards Harmonization and Implications for Government Contractors



Paul E. Pompeo, Partner, Government Contracts, 202.942.5723

Mary Cassidy, Counsel, Compensation and Benefits, 202.942.5565

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Agenda

- Overview of the Pension Protection Act Funding Rules
- Policy Conflicts Between PPA and CAS
- Highlights of CAS Harmonization in the NPRM
- Equitable Adjustments on Contracts: Mandatory Changes vs. Voluntary Changes
- Conclusion

Overview of the Pension Protection Act (PPA)

Funding Rules

- Sweeping changes to rules governing qualified pension plans, including funding requirements for single employer defined benefit plans
- Funding target of 100% of present value (PV) of accrued benefits
- New actuarial assumptions for calculating PV of accrued benefits
- 7-year amortization period for funding shortfalls
- Benefit restrictions for plans < 80% funded
- Changes generally effective in 2008 (transition phase-in rules apply); delayed effective date for certain large government contractors

Policy Conflicts Between the PPA and the CAS

- PPA changes increased disparity between ERISA funding goals and CAS expense goals
 - PPA: Goal is full funding to protect employee retirement and the PBGC
 - Looks at short term funding
 - CAS: Goal is to determine pension cost for contract cost and pricing
 - Looks to long term funding to minimize Government “contributions” through contract cost or price
- PPA directs the CAS Board to promulgate standards to “harmonize” CAS with PPA

Highlights of CAS Harmonization in the NPRM

- CAS recognizes PPA minimum actuarial liability if 3 triggers are met; in determining actuarial liability:
 - CAS continues to measure actuarial accrued liability and normal cost based on “best estimate” actuarial assumptions (CAS 412-40(b)(2))
 - PPA prescribes interest rate assumptions derived from a corporate bond yield curve with 3 segment rates (short/medium/long-term) to be applied based on when accrued benefits are expected to be paid; PPA also prescribes mortality assumptions
- Amortization of gain or loss caused by change in unfunded actuarial liability over 10 years; accelerated gain and loss amortization from 15 to 10 years
 - PPA has a 7-year amortization period for funding shortfalls
- Adjustment to assignable cost limitation if PPA minimum actuarial liability applies

Highlights of CAS Harmonization in the NPRM

- Mandatory cessation of benefit accruals under PPA will not trigger a segment closure accounting under CAS 413.50(c)(12)
- Recognition of increases in benefits under collective bargaining agreements
- Asset values and present value of contributions
 - Generally follows PPA: use of PPA recognition of accrued contributions and fair market value of assets
- Interest and expenses on prepayment credits
- No investment gain or loss on unfunded pension costs
- Transition phase-in over 5 years

Equitable Adjustments on Contracts: Mandatory Changes vs. Voluntary Changes

- Change effective upon award of trigger contract
- Changes required by the Harmonization rule are mandatory changes permitting an equitable adjustment to contracts
- Changes made as an overall review of pension, but not “required” are voluntary changes
 - CAS Board specifically cautions that the rule does not require a change to the actuarial cost method (including AVA) calling it a voluntary change
 - Voluntary change (other than desirable change) can have no increased cost to the government

Conclusion

- Comments due July 9, 2010
- CAS Board review and revision process, final rule not likely until September – December 2010
- PPA compliance required of the large contractors by 2011 even if harmonization rule is not finalized
- Certain to be contractor scrutiny by DCAA with allegations of noncompliance, and hard line positions

Contact

- Paul E. Pompeo, Partner, Government Contracts: 202.942.5723
paul.pompeo@aporter.com
- Mary Cassidy, Counsel, Compensation and Benefits: 202.942.5565
mary.cassidy@aporter.com