OFFICE OF THE UNDER SECRETARY OF DEFENSE

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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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MEMORANDUM FOR DEPUTY ASSISTANT SECRETARY OF THE ARMY
(POLICY AND PROCUREMENT), ASA (ALT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY
(ACQUISITION MANAGEMENT), ASN (RDA)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(ACQUISITON), SAF/AQ
DIRECTORS OF DEFENSE AGENCIES

SUBJECT: Impact of the Pension Protection Act of 2006 on Forward Pricing

The recently passed Pension Protection Act (PPA) of 2006 may require contractors to significantly change the funding of their defined benefit pension plans. Starting in 2006, the PPA will permit companies to voluntarily increase their pension contributions; starting in 2008, the PPA may cause contractors to significantly increase their required minimum pension contribution for tax purposes. However, such funding changes will not necessarily result in increased costs on negotiated contracts (including ACO negotiated/determined Forward Pricing Rates (FPRs)). In reviewing and negotiating any proposed increases in pension costs related to the PPA in negotiated prices and FPRs, contracting officers shall comply with the following policy:

1. Proposed Increased Pension Costs Using Current CAS Rules

The application of the PPA changes are complex and will require review by DoD pension and cost accounting experts. For example, contractors may state that pension cost increases are due to the increased recognition of pension cost in the current year that would have been deferred to future years as assignable cost deficits but for the PPA. When contractors propose increased pension costs based on the current Cost Accounting Standards (CAS) and the PPA, contracting officers shall contact their cognizant Administrative Contracting Officer (ACO) and/or Defense Contract Audit Agency (DCAA) auditor for assistance in reviewing these costs before negotiating the contract price.

2. Proposed Increased Pension Costs in Anticipation of Changes to the CAS

Contracting officers shall not (a) negotiate any increase in contract prices or FPRs related to a potential CAS change resulting from the PPA, nor (b) include re-opener clauses addressing such costs.

For contracts that are subject to full CAS coverage, any changes to CAS 412 and 413 promulgated by the CAS Board as a result of the PPA may entitle the contractor to an equitable adjustment for those contracts as of the effective date of any such amendment or other guidance issued by the CAS Board.

For contracts that are subject only to modified CAS coverage and contracts that are not covered by CAS, FAR 52.216-7, "Allowable Cost and Payment" clause, determines the allowability of pension costs and locks the contract into the version of FAR 31.2 in effect at the date of contract award. Consequently, contractors with contracts awarded prior to any revision to CAS 412 will be obligated by FAR 31.205-6(j)(2) to continue to apply the (pre-revision) version of CAS 412 in effect at the time of contract award. Any change to CAS 412 will not impact these contracts. They will be subject to the CAS 412 in effect at the time of contract award.

In conclusion, contracting officers shall not include in the contract price or recognize as allowable any increased pension costs for anticipated changes to the CAS into any contract or FPR, or include a re-opener clause that would allow adjustment to the contract at a later date. To do so would result in over-recovery of costs by the contractor.

3. Special Rules for Plans of Certain Government Contractors

Under the PPA, contractors that meet the requirements of section 106(c), "Eligible Government Contractor Plan Defined," are subject to a mandatory delayed implementation of Title I of the PPA. Specifically, section 106 of the Act provides:

(a) General Rule- Except as provided in this section, if a plan is an eligible government contractor plan, this subtitle and subtitle B shall not apply to plan years beginning before the earliest of--
(1) the first plan year for which the plan ceases to be an eligible government contractor plan,
(2) the effective date of the Cost Accounting Standards Pension Harmonization Rule, or
(3) January 1, 2011.

(b) . . .

(c) Eligible Government Contractor Plan Defined- For purposes of this section, a plan shall be treated as an eligible government contractor plan if it is maintained by a corporation or a member of the same affiliated group (as defined by section 1504(a) of the Internal Revenue Code of 1986), whose primary source of revenue is derived from business performed under contracts with the United States that are subject to the Federal Acquisition

Regulations (Chapter 1 of Title 48, C.F.R.) and that are also subject to the Defense Federal Acquisition Regulation Supplement (Chapter 2 of Title 48, C.F.R.), and whose revenue derived from such business in the previous fiscal year exceeded $5,000,000,000, and whose pension plan costs that are assignable under those contracts are subject to sections 412 and 413 of the Cost Accounting Standards (48 C.F.R. 9904.412 and 9904.413).

Thus, proposed costs, including forward pricing rate proposals, submitted by contractors maintaining Eligible Government Contractor Plans should not include any amounts resulting from the PPA revised minimum funding standards, such as seven year amortization for funding shortfalls, interest rate assumption based upon corporate bond rates of return, or any other revisions contained in Title I of the Act.

In summary, if the contractor proposes increased pension costs as a result of the PPA, the Contracting Officer should consult with the cognizant ACO and auditor before determining whether to include any proposed costs relating to the PPA in the contract price or FPRs.

If you require additional information, my point of contact for this memorandum is Mr. John McPherson, Senior Procurement Analyst, who can be reached at 703-602-0296 or via e-mail at john.mcpherson@osd.mil.

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