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ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

MEMORANDUM FOR: COMMANDER, UNITED STATES SPECIAL OPERATIONS  
COMMAND (ATTN: ACQUISITION EXECUTIVE)  
COMMANDER, UNITED STATES TRANSPORTATION  
COMMAND (ATTN: ACQUISITION EXECUTIVE)  
DEPUTY ASSISTANT SECRETARY OF THE ARMY  
(PROCUREMENT)  
DEPUTY ASSISTANT SECRETARY OF THE NAVY  
(ACQUISITION AND PROCUREMENT)  
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE  
(CONTRACTING)  
DIRECTORS OF THE DEFENSE AGENCIES  
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Guidance on the Cost Accounting Standards Board Equitable Adjustment Process  
Related to Cost Accounting Standards, December 27, 2011, "Final Rule to  
Harmonize CAS 412 and CAS 413 with the Pension Protection Act of 2006"

On March 27, 2012, I issued a memorandum, "Guidance on Cost Accounting Standards Board ("CASB") Final Rule to Harmonize CAS 412 and 413 with the Pension Protection Act (PPA) of 2006" ("CAS Pension Harmonization"). The memorandum identified several topics that would be addressed in future guidance. The Equitable Adjustment Process was one of these topics and is the subject of this memorandum.

The CASB did not specifically identify required changes resulting from the CAS Pension Harmonization Act. However, application of CAS and FAR dictates that many of the changes found in the CAS Pension Harmonization, i.e., modifications to existing Standards, are to be viewed as required cost accounting practice changes ("Required Changes") that a contractor must make in order to continue to comply with the revised CAS.


Required Changes are subject to equitable adjustments; meaning that certain existing contracts are entitled to be adjusted (based upon a cost impact) in order to absorb their share of the increased costs resulting from the CAS Pension Harmonization. Procedures for processing changes, including the cost impact, to disclosed or established accounting practices are provided in FAR 30.604, and should be followed.

Contracting parties have been developing, submitting, reviewing, and negotiating cost impacts since the establishment of the CAS. For these reasons, this well-defined process will serve well in this instant case. However, it must be recognized that the actual impact of CAS Pension Harmonization on affected contracts can be significant even with relatively minor increases/decreases in the interest rate used to compute the minimum actuarial liability and minimum normal cost. Accordingly, included in the attachment is guidance to ensure that the

adjustment to affected contracts is equitable for both contracting parties. This would include an annual assessment and potential adjustment to the negotiated cost impact based upon looking back and comparing the impact between the forecasted and actual interest rates.

Generally, pension costs are submitted as a centralized payment at the corporate home office level. Accordingly, the Corporate Administrative Contracting Officer (CACO) will be the Cognizant Federal Agency Official (CFAO) and take the lead in working with the Defense Contract Management Agency (DCMA) Contractor Insurance and Pension Review Center (CIPR) group and Defense Contract Audit Agency (DCAA) in reviewing the individual contractor's cost impact proposal. The CFAO will also, in coordination with the Divisional Administrative Contracting Officers (DACOs), Administrative Contracting Officers (ACOs), Procuring Contracting Officers (PCOs) and Program Offices, negotiate the impact on such contracts, and provide instruction on the administration of the adjustment on selected contracts. In the absence of a CACO, the ACO has responsibility to review, coordinate and negotiate the Equitable Adjustment. Payment of the Equitable Adjustment will be from existing funds and no supplemental funds are anticipated.

The key objective is to keep the process as simple as possible, while continuing to protect the interests of the Government. Attached is more specific guidance that responds to frequently asked questions.



Shay D. Assad  
Director, Defense Pricing

Attachments:  
As stated

**“Guidance on the Cost Accounting Standards Board (“CASB”) Equitable Adjustment Process related to Cost Accounting Standards (“CAS”) December 27, 2011” Final Rule to Harmonize CAS 412 and CAS 413 with the Pension Protection Act (PPA) of 2006**

**Question #1: What is an Affected Contract?**

As a result of CAS Pension Harmonization, a certain population of CAS-covered contracts with the United States were priced and negotiated before February 27, 2012 under the previous CAS, while costs for those contracts will be accumulated under the current CAS. These are the affected contracts impacted by the CAS Pension Harmonization. However, the equitable adjustment baseline is limited to the period of performance starting with the applicability of the current CAS, which for calendar year contractors, with a trigger contract, will be January 1, 2013 and running through the remaining period of the negotiated contract performance.

Such parameters as materiality, identification by service and contract type need to be considered, based on the individual contractor's business circumstances. For administrative convenience, it is recommended that contractors consider the creation of affected contracts population through a stratification that identifies only those contracts that are materially impacted by the CAS Pension Harmonization.

DCAA will work with the CFAO in verifying the affected contracts population that is identified and submitted to them by the contractor, as part of the equitable adjustment process.

**Question #2: Can you provide additional guidance relative to estimating future short term rates?**

As stated in the March 27, 2012 memorandum, additional guidance is to be provided relative to the projected rates incorporated in the pension cost calculation as specified in 9904.412-50(b)(7) (iii)(A) and (B). Measurement of these rates in future periods in computing the pension liability is central in accurately forecasting pension costs. Accordingly, the source used for the foundation of these interest rates must be objective and clearly identified. Contractors should be expected to apply judgment to refine these foundational rates, so they reflect consideration of a variety of factors, including historical average rates of return on corporate bonds as well as anticipated future rates of return on corporate bonds. The interest rates developed by the contractor are subject to review for reasonableness by the DCMA CIPR group. Also please review the CAS Board's staff's answer to Frequently Asked Question #11 on CAS Pension Harmonization.

**Question #3: How should the impact of Moving Ahead for Progress in the 21<sup>st</sup> Century (MAP-21) be incorporated into the Equitable Adjustment?**

On July 6, 2012, the President signed into law the legislation titled Moving Ahead for Progress in the 21<sup>st</sup> Century (MAP-21), which contained the Pension Stabilization modifications to minimum funding requirements for qualified defined benefit pension plans. MAP-21 established a corridor/range, based upon the twenty-five year average corporate bond, for the IRS 24 month rates used in computing the Minimum Liability and Minimum Normal Cost component of Cost Accounting Standards (CAS) pension expense under CAS 9904.412-50(b)(7)(iii)(B). Only if the IRS 24 month rates fall outside the 25 year's progressively expanding corridor would the 24 month PPA discount rates be adjusted to fall within the applicable year's 25 year band. The MAP-21 also, in some cases, increased premiums for the Pension Benefits Guaranty Corporation (“PBGC”). For many contractors, the PBGC premiums are funded from pension plan assets. The impact of MAP-21 is cost and pricing data that must be incorporated in computing both the Request for Equitable Adjustment (“REA”) and Forward Pricing Rates.

**Question #4: How should the REA cost impact be measured?**

The baseline for the REA, incorporating the most current pension plan year data (including the most current settlement rates at the time of the negotiation), shall be the difference between computing pension expense using the current CAS 412 (limited to those changes to the CAS pension calculation that are required strictly to comply with CAS Pension Harmonization under 412.50(b)(7)) with the previous CAS 412. The DCMA CIPR group will work with the CFAO and the DCAA in validating both the reasonableness of the data input used by the contractor in computing pension expense and the accuracy of the calculations themselves. As stated in the March 27, 2012 memorandum, in most cases the CACO will be the CFAO responsible for settling the equitable adjustment. This will include the initial step of validating the impact.

The second step in measuring the REA will be identifying the cost impact on affected CAS- covered contracts. As previously mentioned, affected contracts are those that were priced under the previous CAS and will have pension costs allocated to them that are measured under the CAS Pension Harmonization. It is expected that this cost impact in most cases will be accomplished in a Detail Cost Impact format as described at FAR 30.604(g) that identifies the cost impact by contract by year. However, per agreement by contracting parties, a General Dollar Magnitude ("GDM") format is acceptable, when the overall cost impact is not significant and the GDM identifies the impact by year, by contract type, by Agency, and within DoD by service. It is expected that the GDM format will be applicable only in limited circumstances. The CFAO will work with DCAA in reviewing and validating the cost impact.

However, as mentioned in the cover letter, CAS Pension Harmonization, the interest rate sensitivity, offers some unique challenges relative to ensuring that the REA results in equity for both contracting parties. For example, if in the REA the contractor overestimates the interest rate at 412.50(b)(7)(iii)(B), the REA could be much lower than the actual impact of CAS Pension Harmonization. On the other hand, if the contractor underestimates the interest rate at 412.50(b)(7)(iii)(B), the REA could be much higher than the actual impact of CAS Pension Harmonization. For these reasons, the interest rate will be redetermined annually.

Specifically, the contractor's REA submittal will be for all years and all affected contracts that are materially impacted by CAS Pension Harmonization ("Complete REA").

Nevertheless, a "redetermination" for each year covered in the Complete REA will occur once the interest rates used for that year's calculation in the negotiated Complete REA are known. The "redetermination" will be based upon the actual interest rates used in the calculation of that year's CAS pension expense. To facilitate this "redetermination", included in the Complete REA submittal, is identification of the impact on the Complete REA, utilizing interest rates that are 100 basis points higher than those used in the Complete REA. The impact of this interest rate sensitivity analysis will be included in the negotiation of the Complete REA. This "redetermination" will also include the potential impact of a pension plan reaching its Full Funding Limitation, pension plan terminations and any other event that would not result in a CAS pension expense for a year. This approach will result in protecting the interests of both contracting parties.

**Question #5: How should a Contractor's work as a Subcontractor be incorporated into the equitable adjustment?**

The CFAO will negotiate the Complete REA for the entity covered by the CFAO including that portion of the equitable adjustment that relates to that entity's subcontract work it provides for prime contractors "Subcontract EA." The entity's Complete REA (the sum of the Prime and Subcontract REA for that entity)

represents the entity's initial Request for Equitable Adjustment. The Complete REA Adjustment identified to Subcontract EA will then be included in the Prime Contractor's billing to the Government, subject to the "redetermination" adjustment as described in Question #4.

**Question #6: Which contracts should be selected for the Equitable Adjustment?** The Total Negotiated Equitable Adjustment will include both CAS-covered flexibly priced and fixed price contracts. Normal accounting methodology will accumulate costs in the appropriate cost accounting period for that portion of the Total Negotiated Equitable Adjustment attributed to CAS-covered flexibly priced work.

CAS 9903.306(f) permits the Total Negotiated Equitable Adjustment attributed to affected CAS-covered fixed price contracts, i.e., the cost impact on all affected CAS-covered fixed priced contracts both the contractor's prime and subcontract, can be recognized by modifying a single contract, several but not all contracts, all contracts, or any other suitable method. CAS rules "do not in any way restrict the capacity of the parties to select the method by which the cost impact attributable to a change in cost accounting practice is recognized." However, the selected method is required to be documented in a Settlement Agreement.

**Question #7: What are the expected changes to the Disclosure Statement?**

It is our expectation that there is only minimal impact of the CAS Pension Harmonization on Disclosure Statements, if the changes are limited to incorporation of CAS Pension Harmonization. In such cases the review for CAS adequacy and compliance should be accomplished on an expedited basis. Contractor revisions necessary to CASB Disclosure Statement (DS-1) forms as a result of the changes to CAS 412/413 are expected to be limited to:

1. **Amortization Period for Actuarial Gains and Losses:** The change to CAS shortened the amortization period from 15 to 10 years. If a contractor discloses the amortization period for actuarial gains and losses, the regulatory change in this period must be reflected beginning with the contractor's applicability date. However, since the amortization period is prescriptive in the regulation and not a choice of the contractor, a contractor who does not describe this in the disclosure statement will not be required to add it.
2. **Interest Rate Assumption:** The basis of the interest rate used to measure the minimum actuarial liability and minimum normal cost for the current period pursuant to CAS 99074.412-50(b)(7)(iii) is a significant accounting practice. As such, the disclosure statement needs to describe the basis of this interest rate and the contractor must consistently follow its disclosed practice.

For CAS 9904.412.50(b)(7)(iii)(B) to be applicable, the contractor must use the same rate or set of rates as published by the Secretary of the Treasury for the determination of both the minimum contribution required by ERISA and the CAS pension expense. Furthermore, the disclosure statement, at a minimum, shall describe the month and table from which the rate or set of rates were selected. If a contractor elects to use the interest assumption specified in CAS 9904.412-50(b)(7)(iii)(A), the disclosure statement should describe the methodology the contractor uses to develop its interest rate assumption. A change to the disclosed accounting practice for interest rate selection represents a unilateral accounting practice change.

**Question #8: How are non-CAS covered contracts impacted?**

Referenced memo addressed the requirement for the potential use of two rates to cover those situations in which non-CAS covered contracts awarded prior to February 27, 2012 are expected to be in performance for calendar year contractors from the January 1, 2013 and on. Rather than use dual rates to cover these rather limited circumstances, we recommend that contracting parties ensure that the

increased pension costs resulting from the CAS Pension Harmonization are not charged to those non-CAS covered contracts.

Specifically, ACOs with cognizance over contractors that have non-CAS-covered contracts awarded before February 27, 2012 with performance occurring beyond CY 2012 may need to take special measures to administer these contracts. Non-CAS-covered cost type contracts awarded before February 27, 2012 that are expected to continue performance after the CAS Pension Harmonization becomes applicable to the contractor continue to be subject to the previous CAS 412 and CAS 413 cost computation. Contractors may have few, if any, of these contracts. Therefore, as a practical matter, it is acceptable for a contractor to choose to manually adjust costs billed to the government on a contract by contract basis rather than maintain an additional set of indirect rates calculated under the previous CAS 412 and CAS 413. If a contractor elects to manually adjust contracts it must specifically identify this adjustment and identify the contracts subject to the adjustment in any submission to the Government so it can be accurately identified and adjusted. This includes interim billings and annual incurred cost submissions.

**Question #9: What is the CFAO role in coordinating with Special Programs?**

It is important that all actions taken on a company's REA submittal be coordinated with DCMA Special Programs to validate that contractor information is complete. To ensure appropriate coordination, the CFAO will, due to security considerations, utilize DCMA Special Programs to communicate with affected program offices as necessary.

**Question #10: What is the impact of CAS Pension Harmonization on Earned Value Management System ("EVMS") reporting?**

Contracting officers should negotiate adjustments to contract target costs for EVMS/performance measurement baseline purposes reflecting the impact of the CAS Pension Harmonization. This is considered additional scope in an Earned Value environment. This CAS impact has not been included in prior performance measurement baselines established prior to the 27<sup>th</sup> February 2012 CAS Pension Harmonization effective date.

**Question #11: Should profit/fee be considered in the Equitable Adjustment and if so, how should it be handled?**

Since there is no anticipated affect on performance risk resulting from CAS Pension Harmonization, no profit or fee will be included in the negotiated Equitable Adjustment. The purpose of any equitable adjustment will be to fairly reimburse the contractor for the cost of CAS harmonization.