CAS Pension Harmonization Rule (76 FR 81296, December 27, 2011)
Frequently Asked Questions (FAQs)
As of December 27, 2011

FAQs About the Cost Accounting Standards Pension Harmonization Rule.

Set out below are some Frequently Asked Questions (FAQs) regarding the "Cost Accounting Standards (CAS) Pension Harmonization Rule" and other amendments to CAS 412 and 413 that were published on December 27, 2011 (76 FR 81296). The FAQs have been prepared by the CAS Board's Staff to answer questions about the implementation of the CAS Pension Harmonization Rule from users of these Standards and to help users better understand the Rule. The FAQs are the work product of the Staff and do not represent the opinions or conclusions of the CAS Board.

The Staff will consider future amendments to the FAQs as additional questions arise. The public may submit questions for consideration as part of any future amendments to the FAQs by contacting Eric Shipley, Project Director, by e-mail (Eric.Shipley.cms.hhs.gov) or phone (410-786-6381). The public is always welcome to send correspondence on CAS to the CAS Board by email (raymond_wong@omb.eop.gov or casb2@omb.eop.gov.

Disclaimer: This document is only provided as an aid for interested parties. The CAS Pension Harmonization Rule is published as a Final Rule in the Federal Register (FR) at 76 FR 81296. The Final Rule as published in the FR is the official promulgation and is the controlling instrument in the event of any discrepancies between the FR Final Rule and any other document.

Other Aids regarding CAS Pension Harmonization Rule.

The CASB Board has made available on its website copies of CAS 412 and CAS 413 in a line-in/line-out format showing the changes from the existing Standards to the Standards as amended by the final rule published on December 27, 2011. These versions of the Rule and the FAQs can be found under the heading "Harmonization of Cost Accounting Standards 412 and 413 with the Pension Protection Act of 2006" at:
http://www.whitehouse.gov/omb/procurement_casb_index_fedreg/.

FAQs

Q1. What is the "CAS Pension Harmonization Rule?"

The "CAS Pension Harmonization Rule" is paragraph 9904.412-50(b)(7) which was added to Cost Accounting Standard (CAS) 412 by a final rule published at 76 FR 81296 on December 27, 2011. The final rule also amended or added other provisions of CAS 412 and 413. The CAS Board has promulgated these amendments and additions to CAS 412 and 413 to implement the requirements of Paragraph (d) of Section 106 of the Pension Protection Act (PPA) of 2006 (Pub. L. 109-280, 120 Stat. 780). Specifically the PPA required that the Board reconcile (a) the pension cost allocated to Federal contracts that are subject to CAS 412 and 413 and (b) the minimum required contribution under Title 1 of the Employees Retirement Income Security Act (ERISA) of 1974, as amended. Generally the changes to CAS 412 and 413 are referred to a "harmonization."

Besides the amendments required to comply with Section 106(d) of the PPA, the Board made a number of technical corrections unrelated to harmonization. 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).

Q2. Under harmonization, is the pension cost allocable to Government contracts equal to the minimum required contribution?

No. The Board was concerned with the potential for volatility due to changing yield rates on corporate bonds and the relatively shorter 7-year amortization period used to compute the minimum required contribution.

Q3. Has the Board adopted the market-to-market concept that is used by some modern pension accounting rules, i.e., the Internal Revenue Code (IRC) 430 minimum required funding rules and U.S. GAAP?

No. IRC 430 and U.S. GAAP address the minimum required funding and net period pension expense that is necessary to recognize the current period's pension benefits accrued to date if liquidated at the prevailing yield rates on corporate bonds. The CAS develops cost data to negotiate cost-based contract rates for fixed-price and flexibly priced Government contracts that span multiple year. The Board has concluded that the retain the current requirement that actuarial assumptions used to value pension costs must continue to "reflect long-term trends so as to avoid distortions caused by short-term fluctuations" and "represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations."

The only exception is under 9904.412-50(b)(7), CAS Pension Harmonization Rule, that measures a minimum actuarial liability and minimum normal cost based on investment grade corporate bonds with varying maturities and that are in the top 3 quality levels available, such as Moody's' single 'A' rated or higher.

Q4. How are the pension cost allocable to Government contracts and the IRC 430 minimum required contribution being reconciled?

The harmonization final rule accomplishes this by ensuring that the normal cost and amortization of the unfunded liability are sufficient to liquidate the PPA target normal cost and funding target within the amortization period. Depending upon prevailing yield rates on corporate bonds, the pension cost allocable to Government contracts may be greater than the amount needed to liquidate the PPA target normal cost and funding target within the amortization period.

Q5. What are the additions and changes to CAS 412 and 413?

The following chart summarized the additions and changes under the CAS Pension Harmonization final rule.

Change / Addition	CAS 412 & 413 as of [date of ESOP amendments]	CAS Pension Harmonization Final Rule
1) Measurement of Actuarial Liability and Normal Cost	Actuarial Liability and Normal Cost equal Actuarial Accrued Liability and Normal Cost measured using assumptions based on long-term expectations	Actuarial Liability and Normal Cost equal to **greater of (a)** Actuarial Accrued Liability and Normal Cost measured using assumptions based on long-term expectations **or (b) Minimum Actuarial Liability and Minimum Normal Cost based on current yield rates on corporate bond.**
2) Amortization Periods: (i) Experience Gains and Losses …………………… (ii) Other changes in Unfunded Actuarial Liability ………………….	(i) 15 Years (ii) 10 to 30 Years following established practice	(i) **10 Years** (ii) 10 to 30 Years following established practice
3) Benefit Projections: (i) Salary Related Benefits (ii) Dollar per Year Benefits …………………..	(i) Expected Salary Increases (ii) No Projection Permitted	(i) Expected Salary Increases (ii) **If based on CBA, average benefit increase during last 6 years.**
4) Accumulated Value of Prepayment Credits	Adjust using assumed interest rate based on long-term expectations	Adjust using actual return on investments

Change / Addition	CAS 412 & 413 as of [date of ESOP amendments]	CAS Pension Harmonization Final Rule
5) Present Value of Contributions Made After Valuation Date	No specific guidance. Typically either discounted using assumed interest rate or else not discounted following ERISA practice	Must discount using assumed interest rate based on long-term expectations.
6) Mandatory Cessation of Benefit Accruals	Must recognize immediate adjustment equal to actuarial liability minus market value of assets.	**Exempt from immediate recognition if mandated by ERISA (IRC 436(e)). Treat as plan amendment unless plan provides that benefit accruals will be restored and contractor elects to so recognize.**
7) CAS Pension Harmonization Transition		All changes and additions immediately recognized except minimum actuarial liability and minimum normal cost. Minimum actuarial liability and minimum normal cost are phased-in as follows: 0% Year 1, 20% Year Two, 50% Year Three, 75% Year Four and 100% Year 5 and later. Years are measured based on Effective Date of Final Rule.

Q6. When is the computation of the pension cost based on the minimum actuarial liability and minimum normal cost?

The actuarial accrued liability and normal cost are initially valued using actuarial assumptions that are separately identified and "represent the contractor's best estimates of anticipated experience under the plan," and "reflect long-term trends so as to avoid distortions caused by short-term fluctuations." Under the CAS Pension Harmonization Rule, if the sum of the minimum actuarial liability and the minimum normal cost exceeds the actuarial accrued liability and normal cost, then the values of the minimum actuarial liability and minimum normal cost are generally used as the values for the actuarial accrued liability and normal cost in the computation of that period's pension cost. The exceptions are that the minimum actuarial liability and minimum normal cost are not used to determining the amount of assets to be transferred between active or inactive segments and are not used to measure the adjustment due for a segment closing, benefit curtailment or plan termination.

Q7. What is the relationship of the minimum actuarial liability and minimum normal cost used by the CAS to the funding target and target normal cost used by IRC 430?

The CAS Pension Harmonization Rule specifies that the minimum actuarial liability and minimum normal cost must be computed using an interest assumption that reflects "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 and that are in the top 3 quality levels available, e.g., Moody's' single 'A' rated or higher." So the basis for interest assumption(s) set by the contractor for CAS 412-50(b)(7)(iii)(A) purposes is consistent with the basis for durational interest assumptions established by the Enrolled Actuary for compliance with Internal Revenue Code. Moreover, the rule permits the contractor to elect to base its interest assumptions on the same basis as the interest assumptions used for compliance with the requirement of the PPA. If all other assumptions are the same, then the minimum actuarial liability and minimum normal cost may equal the funding target and target normal cost, respectively.

If the contractor must use, or elects to use, different actuarial assumptions for one or more segments covered by the pension plan, then the there will be a difference between the minimum actuarial liability and minimum normal and the funding target and target normal cost that would be separately determined for that segment or segments.

Q8. What about "At Risk " Plans?

CAS 412 and 413 are based on the pension costs of going concerns. All actuarial assumptions, other than the special criteria for the interest assumption for minimum actuarial liability and minimum normal cost, are based on long term expectations. The use of the conservative assumptions regarding retirement, form of payment, etc, that are mandated for pension plans deemed t be "at Risk" would normally not satisfy the requirements of paragraphs 9904.412-40(b)(2) and 9904.412-50(b)(4). However, changed conditions for the pension plan or plan sponsor may require or permit the contractor to change the value or basis for setting its actuarial assumptions. The causes or source of such change in assumptions should be supported by adequate and persuasive documentation, which may include an experience study by the plan's Enrolled Actuary.

Q9. Have the rules governing the actuarial value of assets been amended to permit the use of the actuarial value of assets used for IRC 430 purposes?

No. Other than specific accounting required for contribution made after the end of the play year, 9904.413-40(b) and 9904.413-50(b) have not been amended. The CAS continues to permit the use of any recognized asset valuation method which provides equivalent recognition of appreciation and depreciation of the market value of the assets of the pension plan” that falls “within a corridor from 80 to 120 percent of the market value of the assets.”

Under the PPA for determining the average asset value, the expected rate of return on assets is limited to the lower of the assumed rate of return on assets or the PPA interest rate for third segment. Because of this limitation, the average asset value used for IRC 430 purposes will not always satisfy the requirement for equivalent recognition of appreciation and depreciation, and therefore, may not be used for CAS 413 purposes.

Q10. What interest rate(s) is used for the various interest adjustments required under CAS 412 and 413?

There are several interest adjustments required by CAS 412. The basic concept adopted by the harmonization rule is that adjustments to amounts that are invested shall be adjusted based on the rate of return on the investments. Similarly, adjustments on amounts that are not funded shall be adjusted based on an assumed rate of interest that complies with 9904.412-40(b)(2) and 9904.412-50(b)(4), i.e., a long-term interest assumption.

> **Q10(a). Interest adjustments to prepayment credits –** Prepayment credits represent funds that have been deposited into the funding agency in excess of the pension cost assigned to the period. These funds are comingled with the other investments and are adjusted based on the actual rate of return on investments recognizing the period invested.
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> **Q10(b). Interest adjustments included in amortization installments –** In accordance with 9904.412-50(a)(1) the installments are computed as level annual amount and “each installment shall consist of an amortized portion of the unfunded actuarial liability plus an interest equivalent on the unamortized portion of such liability.” Except for the current installment, amortization installments are components of pension cost that will be funded in future periods. Therefore, the installments are computed using the long-term interest rate assumption.
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> **Q10(c) Interest adjustment on receivable contributions –** Receivable contributions, i.e., contributions made after the date of the actuarial valuation, towards the contract pension cost for the current period are recognized as plan assets on a discounted basis. Because the receivable contributions represent monies that have not yet been deposited,

receivable contributions are discounted from the date of deposit back to the valuation date using the long-term interest rate assumption.

Q10(d) Interest adjustment on pension costs funded after valuation date – Pension costs computed in accordance with CAS 412 and 413 represent the portion of the pension liability assigned to the current cost accounting period as measured on the date of the actuarial valuation. Frequently the assigned pension cost is funded in several installments after the valuation date. Standard actuarial practice requires that the pension costs be adjusted for the time value of money until the date it is funded. Because the pension cost will be funded by the contributions made after the valuation date, the pension cost must be adjusted on the same basis as the receivable contributions. Thus pension costs are adjusted for interest from the valuation date to the date of deposit using the long-term interest rate assumption, regardless of whether the pension cost was computed using the going-concern actuarial accrued liability and normal cost or the minimum actuarial liability and minimum normal cost.

Q10(e) Interest adjustments to unfunded pension costs – As discussed immediately above, contract pension costs represent the portion of the pension liability assigned to the current cost accounting period as measured on the date of the actuarial valuation. Under standard actuarial practice pension costs are adjusted for the time value of money until funded. Unfunded pension costs are therefore adjusted for interest from the valuation date to the next valuation date of date of funding, whichever is earlier, using the long-term interest rate assumption.

Note that the corporate bond yield rate is never used for any of these adjustments, even in periods when the pension cost is based on the minimum actuarial liability and minimum normal cost.

Q11. What Corporate Bond Yield Rate(s) Is Used For Forward Pricing?

The Pension Harmonization Rule, subparagraph 9904.412-50(b)(7)(iii)(A), specifies that "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 and that are in the top 3 quality levels available, e.g., Moody's' single 'A' rated or higher." Alternatively, subparagraph 9904.412-50(b)(7)(iii)(B) permits the contractor to use "the same rate or set of rates, for investment grade corporate bonds of similar duration to the pension benefits, as may be published by the Secretary of the Treasury and used for determination of the minimum contribution required by ERISA." Discounting pension liabilities using interest rates determined for the current period pursuant to either of these subparagraphs results in a settlement-based liability. These current, bond yield-based discount rates are exempted by subparagraph 9904.412-50(b)(7)(iii)(C) from the prohibitions of 9904.412-40(b)(2), requiring use of the same actuarial assumptions for computing the unfunded actuarial liability and other components of pension costs, and 9904.412-50(b)(4), requiring that actuarial assumptions reflect long-term trends. Accordingly, projections or estimations of rates of return on investment grade corporate bonds in future periods must "reflect long-term trends so as to avoid distortions caused by short-term fluctuations" and "represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations."

This means that a presumption that the contractor cannot simply presume that the current rates of return is a valid basis for future periods. In projecting the rate of return on corporate bonds during the years considered by the projections, the contractor must instead examine the historical average rates of return on corporate bond by duration tempered with the recent past and anticipated future rates. It is important that the projected rates do reflect long-term trends given the potential for short-term volatility in corporate bond rates during some market cycles. Paragraph 9904.413-50(b)(2) states that an assumption is reasonable if it is equally like to gains and losses over time. This concept of equivalent expectations of gains and losses is found at 9904.413-50(b)(2). Projections of future rates of return on corporate bonds used in discounting the pension liabilities should not be biased towards either party, and this is best accomplished by forecasting future rates that are have an equal probability of being higher or lower than the actual rate of return.

Q12 Does the CAS Pension Harmonization Rule address how equitable adjustments are to be determined?

No. The measurement of the cost impact for the required changes to cost accounting practices and the processing of equitable adjustments are CAS administration issues. It is expected that necessary guidance will be issued by DOD.

Q13. After the initial year of harmonization, when the annual pension cost measurement basis changes from the actuarial accrued liability and normal cost basis to the minimum actuarial liability and minimum normal cost basis, or vice-versa, is the change treated as a change in cost accounting method or an actuarial gain or loss?

Such changes are a function of the CAS Pension Harmonization Rule and shall be treated as an actuarial gain or loss in accordance with 9904.412-50(a)(v). See Illustration 9904.412-60.1(d) for an example.

Q14. What cost accounting periods are subject to the 9904.412-64.1 Transition Provisions?

The transition provisions phase-in the Minimum Actuarial Liability and Minimum Normal Cost during the [contractor's] first 5 cost accounting periods after June 30, 2012, the Implementation Date of the CAS Harmonization Rule. The transition provisions, as well as the rest of the CAS Harmonization Rule, do not apply until and unless the contractor accepts a new contract subject to CAS 412 and 413 on or after February 27, 2012, the Effective Date of the CAS Harmonization Rule.

Appendix A is a chart that illustrates how the transition provisions will apply depending upon date of contract award.

Q15. How does the phase-in for the 9904.412-64.1 Transition Provisions work?

The following chart summarizes which provisions of the CAS Harmonization Rule apply based on Pension Harmonization Transition Year.

Cost Accounting Period after June 30, 2012*	10 Year Amortization of Gains and Losses	Projection of Flat Dollar Benefits	Prepayments Adjusted Using Return on Investment	Receivable Contributions Discounted at Assumed Interest Rate	Exemption of Mandatory Benefit Curtailment	Phase-In of Minimum Liability and Minimum Normal Cost
Period 1	YES	YES	YES	YES	YES	0%
Period 2	YES	YES	YES	YES	YES	25%
Period 3	YES	YES	YES	YES	YES	50%
Period 4	YES	YES	YES	YES	YES	75%
Period 5	YES	YES	YES	YES	YES	100%

* CAS Harmonization Rule does not apply unless a new contract is accepted after Effective Date.

Q16. If the Minimum Actuarial Liability is less than the Actuarial Accrued Liability and/or the Minimum Normal Cost is less than the Normal Cost, should a Transitional Minimum Actuarial Liability or Transitional Minimum Normal Cost be computed?

Yes. The phase-in applies to the difference between the Actuarial Accrued Liability and the Minimum Actuarial Liability and the difference between the Normal Cost and the Minimum Normal Cost. Because the test required by the CAS Pension Harmonization Rule is based on the sum of the Actuarial Accrued Liability and the Normal Cost compared to the sum of the Minimum Actuarial Liability and the Minimum Normal Cost.

Q17. Does the phase-in apply to the Expense Load on the Minimum Normal Cost?

Yes. Expected expenses may be explicitly or implicitly recognized in the measurement of the Actuarial Accrued Liability or Normal Cost. If expenses are implicitly recognized, it is difficult or impossible to separately identify the built-in expense load. Also, the explicit or implicit expense load might be based on a different measurement basis. Therefore including the expense load in the phase-in of the Minimum Normal Cost ensures that all elements used for the test required CAS Harmonization Rule are considered on a consistent [an equivalent basis].