OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Part 9904

Cost Accounting Standards: Cost Accounting Standards 412 and 413—Cost Accounting Standards Pension Harmonization Rule

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

ACTION: Final rule.

SUMMARY: The Office of Federal Procurement Policy (OFPP), Cost Accounting Standards Board (Board), is publishing this final rule to revise Cost Accounting Standard (CAS) 412, ''Composition and Measurement of Pension Cost,'' and CAS 413, ''Adjustment and Allocation of Pension Cost.'' This revision will harmonize the measurement and period assignment of the pension cost allocable to Government contracts, and the minimum required contribution under the Employee Retirement Income Security Act of 1974 (ERISA), as amended, as required by the Pension Protection Act (PPA) of 2006. The PPA amended the minimum funding requirements for qualified defined benefit pension plans. The Board issues this final rule to revise CAS 412 and CAS 413 to include the recognition of a ''minimum actuarial liability'' and ''minimum normal cost,'' which are measured on a basis consistent with the liability measurement used to determine the PPA minimum required contribution, and accelerate the recognition of actuarial gains and losses. These and other revisions will better align both the measurement and period assignment of pension cost allocable to a contractor's Government contracts and other final cost objectives in accordance with CAS, and the measurement and period assignment requirements for determining the contractor's minimum pension contribution under the PPA.

DATES: *Effective Date:* February 27, 2012.

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SUPPLEMENTARY INFORMATION:

A. Regulatory Process

The Rules, Regulations and Standards issued by the Board are codified at 48 CFR chapter 99. The Office of Federal Procurement Policy Act, 41 U.S.C. 1502(c) [formerly, 41 U.S.C. 422(g)], requires that the Board, prior to the establishment of any new or revised Cost Accounting Standard, complete a prescribed rulemaking process. The process 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, and prepare and publish a report on the issues reviewed, which is normally accomplished by publication of a 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 final rule completes the four-step process.

B. Background and Summary

The Board is releasing a final rule on the revisions to 48 CFR 9904.412 and 9904.413 (respectively, CAS 412 and 413, or 9904.412 and 9904.413) to implement paragraph (d) of section 106 of the Pension Protection Act (PPA) of 2006 (Pub. L. 109–280, 120 Stat. 780).

The PPA amended the minimum funding requirements for, and the tax-deductibility of contributions to, qualified defined benefit pension plans under ERISA. Paragraph (d) of section 106 of the PPA requires the Board to revise CAS 412 and 413 to harmonize the ERISA minimum required contribution and the reimbursable pension cost.

In addition to the revisions to implement harmonization, the Board is making 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. The technical corrections for CAS 412 are being made to paragraphs 9904.412–30(a)(1), (8) and (9); paragraph 9904.412–50(a)(6); 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), paragraph 9904.413–50(c)(1)(i), and paragraphs 9904.413–60(c)(12) and (18).

Different Roles and Responsibilities

The Board recognizes that heightened interest in pension-related matters may attract attention to this regulatory action by members of the public who are not familiar with CAS and the Board. The Board has a limited role, albeit an indirect one, with respect to pension funding, through its rulemaking regarding reimbursement of Government contractor pension costs. Under ERISA, the authority to implement the statute and promulgate rules and regulations regarding the minimum funding requirements for pension plans, tax deductibility of contributions, and protection of participant's rights has been granted to the Department of Treasury, Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC). By contrast, the OFPP Act gave the CAS Board the exclusive authority to ''make, promulgate, amend, and rescind cost accounting standards and interpretations thereof designed to achieve uniformity and consistency in the cost accounting standards governing measurement, assignment, and allocation of costs to contracts with the United States.''

In this preamble, references to ERISA serve to identify and distinguish the federal system of funding requirements and restrictions for qualified pension plans from financial disclosure and reporting guidance, which is also known as generally accepted accounting principles (GAAP), and the CAS. References to ERISA may include: ERISA as amended to date; relevant sections of the Internal Revenue Code (IRC) at Title 26 of the U.S.C.; regulations and other pertinent guidance issued by Treasury, DOL and PBGC; and pertinent case law. The Board acknowledges that the tax deductibility of pension contributions is governed by the IRC at Title 26 of the U.S.C. and refers to the IRC when addressing issues related to tax deductibility. The Board acknowledges the pension funding responsibilities of ERISA as being distinct from the Board's responsibilities under the OFPP Act, which are to establish contract cost accounting standards governing the reimbursement of contract costs, including pension costs. Government contractors must continue to comply with ERISA and its implementing regulations that govern the funding of pension plans. This includes the new minimum funding requirements imposed by the PPA as implemented by Treasury. The Board's rules do not change the minimum funding requirements imposed by ERISA or Treasury's implementing regulations. To the contrary, the Board has changed its regulations to harmonize with the PPA and Treasury's implementing regulations by revising the CAS measurement basis for determining the amount of pension cost allocable to

Government contracts, which is reimbursable through contract pricing.

Prior Promulgations

On July 3, 2007, the Board published a SDP (72 FR 36508) to solicit public views with respect to section 106 of the PPA that required the Board to review and revise CAS 412 and 413. Differences between CAS 412 and 413, and the PPA, as well as potential issues associated with addressing those differences, were identified in the SDP.

The ANPRM (73 FR 51261, September 2, 2008) proposed changes to CAS 412 and 413. These proposed changes included the recognition of a ''minimum actuarial liability,'' a ''minimum normal cost,'' special recognition of ''mandatory prepayment credits,'' accelerated gain and loss amortization, and revision of the assignable cost limitation. Other proposed changes addressed the PPA's mandatory cessation of benefit accruals for severely underfunded plans, projection of flat dollar benefits, recognition of accrued contribution values on a discounted basis, interest on prepayment credits, and prior period unfunded pension costs. The Board also proposed a transition period to phase in certain provisions to promote fairness and equity to the contracting parties, as has been done by the Board in other rulemaking. The public was invited to offer comments on these proposed changes and any other related matters. In response to many respondents who asked for additional time for the submission of additional or supplemental public comments, on November 26, 2008, the Board published a notice (73 FR 72086) extending the comment period for the ANPRM.

After considering the comments received on the ANPRM, as well as the results of further analysis and deliberations conducted by the Board, the Board published a NPRM (75 FR 25982) on May 10, 2010, to solicit public views with respect to the proposed revisions to CAS 412 and 413. The NPRM reflected public comments in response to the SDP and ANPRM, as well as research accomplished by the staff for consideration by the Board.

The NPRM proposed changes to CAS 412 and 413 that were considered necessary to harmonize the minimum required contributions under ERISA for Government contractor pension plans and the Government's reimbursable pension plan costs. The primary proposed changes were the recognition of a ''minimum actuarial liability,'' ''minimum normal cost,'' and an accelerated amortization of actuarial gains and losses. The minimum actuarial liability and minimum normal cost are measured on a settlement basis using the expected payout of currently accrued benefits that have been discounted using yield rates on investment grade corporate bonds with matching durations to forecasted pension benefit payments, and that are in the top three quality levels available, *e.g.,* Moody's grade A and above. 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, interest on prepayments credits, and prior period unfunded pension costs. The Board continued to propose a transition period to phase in certain provisions to promote fairness and equity to the contracting parties, as has been done by the Board in other rulemaking. The public was invited to offer comments on these proposed changes and any other related matters.

A major feature of the NPRM was the proposal that the minimum actuarial liability and minimum normal cost would only be recognized if three threshold criteria were met. Otherwise, the actuarial accrued liability and normal cost are measured on a going concern basis using the expected payout of projected benefits that have been discounted using an interest assumption equal to the expected future rate of return on investments which reflect long-term trends so as to avoid distortions caused by short-term market fluctuations. (Note that the SDP, ANPRM and NPRM referred to this as the ''long-term'' interest assumption.) These threshold criteria, which have been referred to as ''triggers,'' required that:

(i) The ERISA minimum required contribution exceeds the contract pension costs measured on a going concern basis, referred to as ''trigger 1;''

(ii) The sum of the minimum actuarial liability and minimum normal cost exceeds the sum of the going concern actuarial accrued liability and normal cost, referred to as ''trigger 2;'' and

(iii) The contract pension cost measured using the sum of the minimum actuarial liability and minimum normal cost exceeds the contract pension cost measured using the sum of the actuarial accrued liability and normal cost, referred to as ''trigger 3.''

The Board provided illustrations of these proposed revisions in a new section 9904.412–60.1, Illustrations—CAS Pension Harmonization Rule. The illustrations showed the measurement, assignment and allocation of pension cost under the proposed rule for a contractor that separately accounted for pension costs for one segment and an aggregation of the remaining segments.

The NPRM also added language to clarify that any difference between the expected and actual unfunded actuarial liability caused by a change between recognition of the going concern actuarial accrued liability and the minimum actuarial liability would be treated as part of the actuarial gain or loss for the period. The actuarial gain and loss recognition arising from the change in the liability basis (between using the actuarial accrued liability and the minimum actuarial liability) for computing pension costs was illustrated in the NPRM at 9904.412–60.1(h). The proposed structural format differed from the format for 9904.412–60.

The final rule considered the comments and other concerns expressed by the public in response to the NPRM. The Board's responses to the public comments are discussed in Section C—Public Comments to the NPRM.

Basis for Conclusions

Paragraph (d) of section 106 of the PPA instructs the Board to revise CAS 412 and 413, as follows:

> COST ACCOUNTING STANDARDS PENSION HARMONIZATION RULE—The Cost Accounting Standards Board shall review and revise sections 412 and 413 of the Cost Accounting Standards (48 CFR 9904.412 and 9904.413) to harmonize the minimum required contribution under the Employee Retirement Income Security Act of 1974 of eligible government contractor plans and government reimbursable pension plan costs not later than January 1, 2010. Any final rule adopted by the Cost Accounting Standards Board shall be deemed the Cost Accounting Standards Pension Harmonization Rule.

In deliberating and deciding upon a final rule, the Board adopted the following criteria for harmonizing the minimum required contribution under ERISA:

- Accounting rules must satisfy the Board's Statement of Objectives, Policies and Concepts (57 FR 31036 published July 13, 1992);
- Accounting rules must promote fairness and equity to both contracting parties;
- Measurement of pension costs must be objectively verifiable;
- Accounting rules must keep volatility to a minimum in the pricing of Government contracts; and
- Accounting rules must be understandable, particularly given the complexity of CAS 412.

Throughout the comment process afforded by the SDP, ANPRM, and NPRM, many respondents commented that ''harmonize'' under PPA section 106(d) meant that it was Congress's intent that the Board adopt ERISA's minimum required contribution for measuring, assigning, and allocating pension costs to CAS-covered contracts. Further, these commenters stated that the plain meaning of ''harmonize,'' as defined in various dictionaries, would lead to an identical conclusion. The Board's review of the PPA, as well as its legislative history, did not reveal evidence of any such Congressional intent.

The Board has historically recognized that financial accounting policies and procedure, *i.e.,* GAAP, and tax accounting rules have inherently different goals from Government contract cost accounting that preclude their use for the appropriate measurement, assignment and allocation of pension costs for CAS. In the Board's view, PPA section 106 did not seek to change that historical recognition. Based on the Board's analysis, entirely adopting either financial accounting or tax accounting rules for CAS 412 and 413 would have resulted in inequities and unfairness to both contracting parties. The Board noted that the public commenters most directly affected by the CAS Pension Harmonization Rule tended to agree with the NPRM provisions, except for a few matters which are discussed later in this preamble.

The Board continues to believe that CAS 412 and 413 should reflect the continuing nature of the pension plan sponsored by a going concern, as well as the multi-year nature of the contractual relationship between the Government and contractors in the acquisition process. The CAS are intended to provide consistent and accurate cost data to determine the incurred cost for the current period and for the forward pricing of Government contracts over future years for multi-year contracts. With regard to pension accounting, both financial accounting and ERISA have taken a market-based approach toward pension liabilities, which are often referred to as ''mark-to-market'' liabilities. This approach is less predictable for purposes of projecting future costs than the going concern basis of CAS and, therefore, is less useful than CAS for forward pricing purposes for multi-year contracts.

The Board recognizes that contract cost accounting must address the risks to both the contractor and the Government associated with inadequate funding of a plan's current period settlement liability measured on a ''mark-to-market'' basis. This final rule addresses this risk by recognizing a minimum actuarial liability and minimum normal cost that is based on currently accrued benefits valued using the top three quality levels of investment grade corporate bond rates consistent with the PPA criteria as cited in the IRC at 26 U.S.C. 430(h)(2)(D)(i).

ERISA's ''funding target'' and ''target normal cost'' were introduced by the PPA and are mark-to-market values consistent with the measurement basis for the minimum actuarial liability and minimum normal cost. The CAS recognition of the minimum actuarial liability and minimum normal cost ensures that the annual pension cost as measured and assigned under CAS is at least sufficient to liquidate ERISA's target normal cost currently and the unfunded target liability on an amortized basis. Therefore, recognizing the minimum actuarial liability and minimum normal cost will reduce differences between the CAS assigned cost and the ERISA minimum required contribution, although the CAS assigned cost may sometimes exceed the ERISA minimum required contribution. Maintaining the going concern basis for Government contract costing will allow contractors to set multi-year funding goals that avoid undue volatility in cash flow requirements.

The Board was persuaded by public comments that the proposed threshold criteria (''triggers'') for recognition of the minimum actuarial liability and minimum normal cost were overly complex and might create inequities. The final rule only retains the criterion that assesses whether the sum of the minimum actuarial liability and minimum normal cost exceeds the sum of the actuarial accrued liability and normal cost. If the contractor computes pension costs on a composite basis for the plan as a whole, then the criterion should be examined at the plan level. However, if 9904.413–50(c)(2) or (3) require the contractor to separately compute pension costs for a segment, or if the contractor so elects, the criterion should be separately examined at the segment level. This may mean that some segments might use an actuarial accrued liability and normal cost to compute pension costs, and other segments might use the minimum actuarial liability and minimum normal cost. This ensures that variance in demographics or funding levels between different segments is recognized.

ERISA imposes minimum funding requirements on qualified defined benefit plans based on a conservative measurement of the plan's liability and normal cost. It should be noted that the measurement mandated for ERISA minimum funding approximates the value of a bond portfolio required to liquidate the stream of expected payments for accrued benefits if purchased in the current market. While the purchase of such a bond portfolio would not transfer all asset and demographic risks to a third party, this measurement emulates the costs of self-insuring the pension fund against the liability for accrued benefits and represents the mark-to-market (settlement) value without the premium charge for transfer of risk. The final rule requires that contract cost accounting for pension costs must recognize a mark-to-market (settlement) based liability and normal cost as minimum values for CAS. By doing so, the Board believes that any ERISA minimum required contribution in excess of the allocable contract pension cost amount will be reconciled and reflected in contract pricing in the near term because, by definition, the CAS liability and normal cost would be equal to or greater than the minimum values determined under the settlement liability. Furthermore, by recognizing the settlement liability and normal cost as minimum values, this final rule will benefit the procuring agencies, as well as taxpayers, by minimizing the Government's exposure to the financial risk of unfunded actuarial liabilities as funding progresses.

In order to promote equity and fairness in achieving an orderly change in the contract cost accounting for pension costs, this final rule retains the transition period consisting of five cost accounting periods, the Pension Harmonization Rule Transition Period, that will phase in recognition of any adjustment of the actuarial accrued liability and normal cost. This transition method will apply to all contractors with contracts subject to CAS 412 and 413.

Because modern actuarial software programs can value the same data set multiple times using different assumptions, the final rule is designed to allow 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 externally verified data from ERISA and financial statement valuations while allowing contractors to avoid unnecessary additional actuarial effort and expense.

Summary of Final Rule

The primary harmonization provisions are consolidated within the ''CAS Pension Harmonization Rule'' at 9904.412–50(b)(7). This consolidation eliminates the need to revise many long-standing provisions of CAS 412 and clearly identifies the special accounting practices required for harmonization. Some revisions to other provisions of CAS 412 and 413 are also necessary to achieve the full result. These basic changes to CAS 412 and 413 are as follows:

(1) *Recognition of a ''minimum actuarial liability'' and ''minimum normal cost.''* CAS 412 and 413 continue to measure the actuarial accrued liability and normal cost based on a going concern basis using ''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 mark-to-market liability as a minimum value, the final rule requires that the measured pension cost must be determined using the minimum actuarial liability and minimum normal cost if a specific threshold criterion is met. That is, if the sum of the minimum actuarial liability and the minimum normal cost (as measured using current yield rates on the top three quality levels of investment-grade corporate bonds) exceeds the sum of actuarial accrued liability and normal cost (as measured using the expected rate of return on investments), the contractor must measure the pension cost for the period using the minimum actuarial liability and minimum normal cost. Furthermore, if the criterion is met, the minimum actuarial liability and minimum normal costs are used for all purposes of measurement, period assignment, and allocation under CAS 412. However, the minimum actuarial liability is not recognized for the purposes of 9904.413–50(c)(8), (9) and (12).

The minimum actuarial liability and minimum normal cost are measured under the accrued benefit cost method based on the current yield rate on the top three quality levels of investment-grade corporate bonds. Measuring the minimum actuarial liability and minimum normal cost on a current mark-to-market basis better aligns the CAS measurement with current accounting and economic theory. In addition, the minimum actuarial liability definition is consistent with the ERISA's funding target and the GAAP's ''accumulated benefit obligation.'' The minimum normal cost is similarly defined to be consistent with the ERISA's ''target normal cost'' and the GAAP's ''service cost'' (without salary projection).

(2) *Accelerated Gain and Loss Amortization.* The final rule accelerates the assignment of actuarial gains and losses to accounting periods by decreasing the amortization period from a fifteen-year to ten-year period. This accelerated assignment will reduce the period of deferral in cost recognition and is consistent with the shortest amortization period permitted for other portions of the unfunded actuarial liability (or actuarial surplus). Paragraph 9904.412–64–1(b)(5) of the transition provisions clarify that the ten-year amortization of gains and losses begins with the first cost accounting period this final rule is applicable to the contractor.

(3) *Mandatory Cessation of Benefit Accruals.* This final rule exempts any curtailment of benefit accrual required by ERISA from immediate adjustment under 9904.413–50(c)(12). Voluntary benefit curtailments will remain subject to immediate adjustment under 9904.413–50(c)(12).

(4) *Projection of Flat Dollar Benefits.* The final rule allows the projection of increases in specific dollar benefits granted under collective bargaining agreements. The recognition of such increases is limited to the average increase in such benefits over the preceding six years, limited to benefits governed by collective bargaining agreements. As with salary projections, the final rule will discontinue projection of these specific dollar benefit increases upon a segment closing, which uses the accrued benefit cost method to measure the actuarial accrued liability.

(5) *Present Value of Contributions Receivable.* For both qualified and nonqualified defined benefit plans, the final rule discounts contributions attributable to the prior accounting period but made after the asset valuation date, *i.e.,* the contribution receivable, at the expected rate of return on investments assumption that reflects long-term trends (assumed interest rate) from the date actually paid back to the valuation date. In considering the public comments on interest crediting on application of prepayment credits and the FAR 31.205–6(j)(2)(iii) quarterly funding requirement, the Board also reviewed the provisions on interest adjustments on pension costs, contributions receivable, prepayment credits, and unfunded pension costs. The assumed interest rate is used to adjust amounts not yet funded, such as receivable contributions, quarterly pension costs, and unfunded pension costs. This is consistent with the general provision of 9904.412–40(b)(2) that the assumed interest rate must be based on expected rates of return on investments, except for the interest rate used to measure the minimum actuarial liability and minimum normal cost. However, interest adjustments on invested monies, such as the prepayment credits, are adjusted at the actual rate of return on the assets.

(6) *Interest on Prepayments Credits.* Generally, the funding of pension plans is a financial management decision made by the contractor, and must satisfy the minimum funding requirements of ERISA. Thus, funding more than the pension cost measured and assigned under CAS is entirely possible. Funding in excess of the CAS assigned costs results in a prepayment for the purposes of CAS. Since all monies deposited into the funding agency are fungible and 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 all other invested monies. This recognition ensures that any investment gain or loss attributable to the assets accumulated by prepayments does not inequitably affect the gains and losses of the plan or any segments. A decision to fund in excess of the CAS assigned cost should have a neutral impact on Government contract costing, although it might have a transitory negative impact on the contractor's cash flow.

(7) *Transition Period to Phase In Minimum Actuarial Liability and Minimum Normal Cost Mitigates Initial Impact of the Potential Increase.* The changes to CAS 412 and 413 are phased in over a transition period consisting of five cost accounting periods, the Pension Harmonization Rule Transition Period. The phase in allows the cost impact of this final rule to be gradually recognized in the pricing and costing of CAS-covered and FAR-covered contracts alike. It also moderates the difference in the pension cost allocable to FAR-covered fixed price contracts entered into prior to the effective date of the CAS Pension Harmonization Rule that are not subject to equitable adjustment. The final rule was revised so that the transition period in the proposed rule is now a fixed schedule for the first five cost accounting periods, the Pension Harmonization Rule Transition Period, following the ''Implementation Date'' so that the transition does not extend unduly beyond the time needed for the contract pricing and budgetary systems to migrate from the existing rule to the CAS Pension Harmonization Rule. Also, the Board has modified the transition

schedule slightly to lessen the impact on contract prices and agency budgets in the near-term. To accomplish this, the difference between the minimum actuarial liability and the going concern actuarial accrued liability, and the difference between the minimum normal cost and the going concern normal cost, are recognized on a scheduled basis during the Pension Harmonization Rule Transition Period, the first five cost accounting periods that this rule is applicable. Under the revised schedule, 0% of the difference will be recognized in the First Cost Accounting Period, 25% in the Second Cost Accounting Period, 50% in the Third Cost Accounting Period, 75% in the Fourth Cost Accounting Period, and finally, 100% in the Fifth Cost Accounting Period. After the completion of the Pension Harmonization Rule Transition Period, 100% of the minimum actuarial liability and minimum normal cost are recognized, if applicable. While 0% of the difference is recognized in the First Cost Accounting Period, there will be other incremental differences, *e.g.,* the change to ten-year amortization of gains and losses.

(8) *Extended Illustrations.* Many illustrations in 9904.412–60 have been updated to reflect the proposed changes to CAS 412 and 413. To assist users with understanding how this final rule will function, examples have been added in a new section, ''9904.412–60.1 Illustrations—CAS Pension Harmonization Rule.'' This section presents illustrations showing the measurement and assignment of pension cost for a contractor's pension plan that meets the criterion of the 9904.412–50(b)(7) CAS Pension Harmonization Rule. The actuarial gain and loss recognition arising from the change in the liability basis (between using the actuarial accrued liability and the minimum actuarial liability) for computing pension cost is illustrated in 9904.412–60.1(d). This structural format differs from the format of 9904.412–60, Illustrations.

C. Public Comments to the Notice of Proposed Rulemaking

The Board received 20 public comments to the NPRM. These comments came from Federal agencies, contractors, professional and trade associations, actuaries, and individuals. As with the ANPRM and SDP, the Board found the public comments to be focused, well developed, and informative. The Board appreciates the efforts of all parties who submitted comments. The public comments to the NPRM may be viewed at: *http://www.whitehouse.gov/omb/casb_index_public_comments/*, or *http://www.regulations.gov.*

Summary of Public Comments

Many of the public commenters believed that, while the NPRM represented progress towards harmonizing the minimum required contribution under ERISA and reimbursable pension plan costs, the proposed three threshold criteria (''triggers'') for recognition of the minimum actuarial liability were an obstacle to adequate recognition of the contribution requirements of ERISA.

Some of the commenters continued to recommend that the Board accept the PPA's mark-to-market based accounting as the only basis for contract cost accounting. Several commenters believed that full harmonization could only be achieved by the direct recognition of mandatory prepayment credits. The public comments also included many detailed recommendations regarding how the proposed rule might be corrected or clarified.

Most of the public comments reiterated concerns that the differences between CAS and the PPA have the potential to cause cash flow problems for some Government contractors. Although there were diverse views on how to best achieve that goal, timely recognition of the ERISA minimum required contribution in contract costing was often recommended. Some commenters believed that section 106 of the PPA requires CAS 412 and 413 to be identical to PPA's minimum required contribution.

Many commenters believed that the Board should remove the proposed first threshold criterion, which some commenters referred to as ''trigger 1,'' that compared the pension cost measured on a going concern basis to the ERISA minimum required contribution. They noted that this criterion not only added complexity to the proposed rule, but also unnecessarily delayed the recovery of previously accumulated prepayment credits. Some of these comments also suggested that the Board remove the second threshold criterion (''trigger 2''), which compared the total liability for the period measured on a going concern basis (*i.e.,* the actuarial accrued liability and normal cost) to the total liability for the period measured on a mark-to-market basis (*i.e.,* the minimum actuarial liability and minimum normal cost). These commenters believe that the only necessary limitation on use of the minimum actuarial liability would occur when the pension cost measured on a going concern basis already exceeded the pension cost on a mark-to-market basis.

Many public comments objected to the segment closing and benefit curtailment provisions that excluded the recognition of the minimum actuarial liability. These commenters expressed their belief that such an exception could reverse the cost recovery and be non-compliant with the mandate of section 106 of the PPA.

Some public comments expressed a concern that the proposed transition rules would delay full recovery and believed that the Board should address contract cost accounting and not budgetary impacts. On the other hand, several commenters believed that the delay caused by the transitional phase in rule was a reasonable compromise that allowed the Government and contractors to gradually implement the effect of the magnitude of the cost increase on the forward pricing process.

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 the CAS Pension Harmonization Rule.

Responses to Specific Public Comments

Topic 1: Harmonization.

Comments: Some commenters focused on the meaning of the Congressional mandate under section 106 of the PPA, the proposed continued recognition of pension liabilities on a going concern basis, and the relationship between the pension cost for contract costing and the ERISA minimum required contribution. One commenter stated that ''By allowing the recognition of the MAL and MNC [*minimum actuarial liability and minimum normal cost*] (*sic*) in determining the CAS cost, without precondition, eventually the CAS assignable cost should catch up with the ERISA funding requirements and full harmonization should be reached.''

One public comment suggested that compliance with PPA section 106 required adoption of the measurement and period assignment provisions of the PPA. This commenter believes that the NPRM as proposed did not fully implement the mandate of section 106 because the Board did not adopt the measurement and amortization rules of the PPA. The commenter stated that *Webster's II New College Dictionary* (3d ed. 2005) defines ''harmonize'' and ''harmony'' to mean ''agreement.''

Two commenters argued that ''the best approach to harmonization would be to revamp CAS 412 and 413 to follow PPA, with modifications as necessary to meet the unique requirements of government contracts.'' One of these commenters quoted the Merriam-Webster's Online Dictionary which defines ''harmonize'' as ''to bring into consonance or accord.''

On the other hand, one commenter believed that harmonization is a more generalized goal meaning to achieve ''equity between the parties.'' And, another public commenter asked the Board to consider the language of section 106, which tells the Board to ''harmonize the [*ERISA minimum required contribution*] (*sic*) **and** government reimbursable pension plan costs, not harmonize CAS **with** the PPA.'' [Emphasis Added]

Three public commenters reminded the Board that the primary concern that prompted section 106 was the difference between the pension funding requirements imposed by ERISA and the delayed reimbursement of pension cost under contracts subject to CAS 412 and 413. Some commenters identified areas of concern that they believed were preventing the proposed rule from providing timely recovery of pension contributions.

Another public commenter reminded the Board that improving the timeliness of pension cost recovery was a goal of the NPRM writing that ''While pension funding rules have changed with the enactment of the PPA, this principle of equity—where the government does not excuse itself from requirements it is imposing on all plan sponsors—remains.'' This commenter believed that the CAS Pension Harmonization Rule, as proposed, failed to satisfy that objective and provided specific suggestions for improvement.

In contrast to the comments that the Board should fully adopt or more closely follow the measurement and amortization rules of the PPA, one commenter was concerned that ''the CAS Board is straying from the intent and historical precepts of contract cost accounting and veering toward tax-driven cash accounting.'' This commenter examined the goals of the Cost Accounting Standards vis-à-vis the goals of the PPA:

> As the Board's response notes, ''strictly tying pension accounting to settlement liabilities and current fair market values will cause volatility that will be counterproductive to predictability and disrupt the contract forward pricing process. Contract price predictability must remain a critical concern for the Board. ''

The commenter's letter continues:

> The long standing concept of accounting is that pension plans are presumed to continue absent evidence to the contrary. We understand that actuaries include assumptions concerning settlement payment (lump sum) elections by terminating and retiring employees—thus the likely risk of paying the extra settlement cost is already anticipated in actuarial measurements. Furthermore, the expected return on investment should reflect a contractor's investment policy for the plan, rather than theories of financial economics that are in vogue.

Several public commenters suggested that success in achieving harmonization should be measured by reduction in ''mandatory'' prepayment credits, where mandatory prepayments refers to minimum funding requirements in excess of the allocable pension costs measured and assigned in accordance with CAS 412 and 413. These commenters were not only concerned with the prospective harmonization of the contract cost with the ERISA minimum contribution once the CAS Pension Harmonization Rule was applicable, but also with a reduction in the substantive mandatory prepayment credits that had been accumulated since the passage of the PPA and the recent dramatic decline in asset values.

One public commenter stated this concern directly: ''Under the NPRM, there is no mechanism present to ensure that contractors will be able to assign mandatory prepayment credits.'' This commenter later continued: ''To eliminate these situations in which recovery of accumulated mandatory prepayment credits are indefinitely delayed, we ask the Board to reintroduce the mandatory prepayment credit mechanism that was contained in the ANPRM.''

Another commenter expressed the belief that: ''Without such amortization, [mandatory prepayment credits] (sic) are not recovered in a reasonable time period, and situations may arise where the balances are inaccessible.'' This commenter cautioned the Board that: ''Without these suggested changes, we respectfully submit that the Board will not have met its mandate under section 106 of the PPA.''

Response: As previously stated, the Board's review of the PPA, as well as its legislative history, did not reveal any expression of Congressional intent that ''harmonize'' under PPA section 106(d) requires the Board to adopt ERISA's minimum required contribution for measuring, assigning, and allocating pension costs to Government contracts. The Board's historical recognition that financial accounting and tax accounting rules have inherently different goals, that preclude them from being used for Government contract cost accounting, is well established. In the Board's view, PPA section 106 did not seek to change that historical recognition. Based on the Board's analysis, adopting either financial accounting or tax accounting rules for contract cost accounting purposes would have resulted in inequities to both contracting parties. The Board noted that the contracting parties most directly affected by the CAS Pension Harmonization Rule tended to agree with the general concepts articulated in the NPRM, except for a few matters which are dealt with later in this final rule.

The Board does not believe adopting tax accounting rules, which establish a funding range rather than an accrual for the period, is appropriate for contract cost accounting purposes. Recognition of the minimum actuarial liability is a reflection of the potential risk of inadequate funding imposed by the ''mark-to-market,'' *i.e.,* settlement liability, in the event that there is an immediate liquidation of the pension plan. To accomplish this, the minimum actuarial liability and minimum normal cost are treated as minimum values to the actuarial accrued liability and normal cost measurements. Apart from these minimum values, the measurement and period assignment rules continue to be based on the going concern concept wherein actuarial assumptions reflect long-term trends and avoid distortions caused by short-term fluctuations, which the Board has determined appropriate for contract cost accounting purposes. Furthermore, recognition of no less than the minimum actuarial liability and minimum normal cost for contract costing purposes ensures that over time the assignable pension cost is at least equal to the ERISA minimum required contribution computed using the funding target liability and target normal cost, which are mark-to-market values.

By ensuring that the pension cost measurement recognizes the minimum actuarial liability and minimum normal cost in a manner similar to the basis for the PPA's funding target and target normal cost, the Board believes that the final rule will over time accumulate contract pension costs that are at least equal to the accumulated value of the PPA minimum required contributions.

The Board agrees that timely recovery of the accumulated prepayments is essential to the degree practicable, but notes that there are some situations where recovery opportunities are limited, *i.e.,* overfunded plans with benefits that have been frozen. Section 106 of the PPA did not require direct reduction of accumulated prepayment credits when CAS is harmonized. However, the Board acknowledges the importance of such a reduction, and the final rule will improve recovery of accumulated prepayment credits through recognition of the higher of either the settlement or going concern liability.

Topic 2: Proposed Threshold Criteria

Comments: Several public commenters believed that the proposed rule was too complex because it combines going concern and settlement measurements. One public commenter expressed the belief that ''the Board's goal—to create a version of CAS that harmonizes with both the minimum funding requirements of PPA and the historical versions of CAS 412 and 413—is not viable.'' Another commenter believed that continuing to compute an actuarial accrued liability and normal cost measured using an expected rate of return on investments as the interest assumption, solely for Government cost accounting purposes, would add a layer of complexity and expense that is not warranted, and which could not be directly verified. And one public commenter remarked that the description of the ''minimum required amount'' needed clarification.

The industry associations were generally supportive of the proposed rule and believed that ''use of the new liability measure, the minimum actuarial liability (MAL), in conjunction with the existing actuarial accrued liability (AAL) provides for a balanced liability measurement despite varying economic circumstances and is a reasonable balance between long- and short-term approaches.'' Another commenter also gave general support for the rule as proposed, writing:

> We understand that given the urgency of the mandate to harmonize CAS, the CASB has chosen an approach to make modifications to the existing CAS rules rather than undertake a complete overhaul of the rules. We understand and support this approach. In addition, we continue to support the CAS modifications to adopt the PPA-like minimum actuarial liability (MAL) and shorter ten-year amortization period for actuarial gains/losses in order to achieve harmonization.

In addition to the concern with complexity from using two different liability measures, a commenter found that imposition of a series of three threshold criteria as a prerequisite for recognizing the minimum actuarial liability and minimum normal cost values created a complexity that potentially would make the rule unmanageable.

First Threshold Criterion (''Trigger 1'')

The first of the proposed threshold criteria, *i.e.,* ''trigger 1,'' was the primary concern expressed in many public comments about the proposed rule. Most of the commenters believed that ''trigger 1'' prevented harmonization by limiting the periods during which the minimum actuarial liability could be recognized. Based on several analyses of ''trigger 1,'' these commenters concluded that ''trigger 1'' retarded the recovery of prepayments accumulated before and after the applicability of the CAS Pension Harmonization Rule.

Other concerns that were raised included the difficulty in predicting the minimum required contribution for forward pricing and the added volatility caused by using multiple ''triggers.'' These commenters uniformly urged the Board to eliminate ''trigger 1.''

One commenter offered the following observations to assuage the Board's concerns with inappropriate increases in contract pension costs:

> But note that even with the elimination of this gateway, there would still be the five-year transition phase-in, the longer amortization period (a ten-year period versus the seven-year period in PPA), and greater asset smoothing than is permitted in PPA. These features will adequately control the cost increases that would otherwise be seen with a more direct and immediate harmonization.

Another commenter remarked that, if the Board had added to the NPRM the three ''trigger'' prerequisite for using the minimum actuarial liability and minimum normal cost as a way of responding to its comment on the ANPRM, then the commenter believed that its prior recommendation was not properly implemented in the NPRM:

In our ANPRM letter, we stated the following:

> If the intent of the CAS Harmonization Rule is to adjust the CAS assignable costs so that the excess of the PPA funding requirements over the CAS assignable costs are recovered on a timely basis, increasing the regular AAL to the MAL when the CAS cost is already greater than the PPA funding requirement for a given year may not be necessary, particularly if there are no existing prepayment credits.
>
> It appears that our suggestion was partly considered. However, Threshold Test 1 does not consider the existence of (mandatory) prepayment credits; it considers only the annual comparison of the minimum funding requirement and the regular CAS cost. As a result, it is too restrictive and will hinder full recovery of minimum funding requirements particularly for contractors who have been subject to the PPA requirements since 2008. Pension plans will eventually require funding contributions lower than CAS costs because the plans will become fully funded under the PPA earlier than when they will become fully funded under CAS. The plans will become fully funded under the PPA sooner because of the following reasons:
>
> • The PPA became effective before the CAS Pension Harmonization Rule will become effective.
>
> • The PPA has a 7-year amortization for unfunded liabilities, compared to the ten-year amortization period for gains/losses and even longer amortization periods for other amortization bases (*e.g.,* plan amendments, assumption changes, *etc.*) in the NPRM.
>
> • The MAL and MNC are phased in and are not fully recognized during the transition period.
>
> Thus, plans will fail the ''trigger 1'' threshold test before contractors can recover all of the minimum funding contributions required of them.

Second and Third Threshold Criteria (''Trigger 2 and Trigger 3'')

Several commenters recommended that the Board also eliminate ''trigger 2,'' which requires that the sum of the minimum actuarial liability (MAL) and the minimum normal cost (MNC) exceed the sum of the actuarial accrued liability (AL) and normal cost (NC) as a precondition for recognition of the minimum actuarial liability and minimum normal cost. The general recommendation was to retain only the final threshold criterion, *i.e.,* ''trigger 3'' and eliminate ''trigger 2'' because it was duplicative and added unnecessary complexity. One of these commenters believed that rather than comparing the liabilities and normal costs as a pre-condition, the rule should simply use the contract pension cost computed using the minimum actuarial liability and minimum normal cost as a minimum pension cost:

> Considering the ANPRM's ''MAL > AL'' criterion and how it impacts the calculations, we recommended that *if no (mandatory) prepayment credits exist and if the regular CAS cost already exceeds the PPA minimum funding requirement,* then the CAS cost need not be adjusted to reflect the MAL and the MNC to result in an even higher CAS assignable cost. Our recommendation was intended for the specific—and less frequent—situations when CAS reimbursements will have already caught up with the ERISA required cash funding of the plan on a cumulative basis, *i.e.,* when there are no mandatory prepayment credits.
>
> In our ANPRM comment letter, we also recommended considering a minimum CAS cost approach for harmonization, *in lieu of* the ''MAL > AL'' criterion. In other words, there is no need to impose a ''MAL > AL'' criterion when satisfaction of this criterion simply results in reflecting the MAL and the MNC as ''floor'' liabilities and normal costs in the calculations. Instead, we recommended directly calculating the CAS cost based on the MAL and MNC, and use the result as a floor for the CAS cost.

Some commenters made suggestions for improving the second criterion (''trigger 2'') if retained in the final rule. One commenter recommended that the final rule should ''provide that when ERISA or GAAP asset, liability, cost, or other values are to be used for CAS purposes, such values are per se CAS-compliant amounts. This will avoid unnecessary disputes with government auditors regarding whether these values are appropriate.''

Another public comment recommended that ''the Board restore the ANPRM interest rate definition as it provides the necessary leeway for contractors to set interest rates assumptions that will be more stable than rates tied to current periods. Along with this definition, it will be helpful to retain the NPRM provision allowing the PPA rates as a safe harbor option.'' The comment noted that the ANPRM required that the interest rate be based on ''high quality'' corporate bonds, rather than the NPRM requirement that the rate be based on ''investment grade'' bonds.

Response: The Board has been persuaded to eliminate the first threshold criterion (''trigger 1''), which was proposed in the NPRM, from the final rule. This test, which had been recommended in public comments to the ANPRM, adds complexity and inserts the vagaries of tax accounting into contract cost accounting.

The Board has reviewed the advantages and disadvantages of retaining either the second threshold criterion (''trigger 2'') or the third threshold criterion (''trigger 3'') as the single prerequisite for using recognition of the minimum actuarial liability and minimum normal cost. Based on this review, the Board has concluded the second criterion directly implements the Board's intent that the minimum actuarial liability and minimum normal cost are minimum values for the pension cost measurement. The Board also notes that unless the second criterion is satisfied, the effort needed to compute the contract pension cost using the minimum values is not necessary. Moreover, first determining which liability to use lessens the potential for computation errors because the contract pension cost needs to be computed once instead of twice. Therefore, the third threshold criterion, ''trigger 3,'' has also been eliminated.

The interest rate criteria used for measuring the minimum actuarial liability and minimum normal cost proposed in the NPRM referenced ''investment grade'' fixed-income investments, which infers the top four levels of investments (*e.g.,* Moody's Baa or higher) and differed from the ANPRM reference to ''high quality'' (*e.g.,* Moody's Aa or higher) fixed-income investments, which as used for GAAP is restricted to the top two levels of investments. The Board believes that the criterion of ''the top three quality levels of investment grade'' is appropriate because it is restricted to the higher tier ratings from the bond rating agencies, *e.g.,* Moody's' single ''A'' rated or higher, and is consistent with the investment quality required by the PPA as cited in 26 U.S.C. 430(h)(2)(D)(i). A lesser rated bond would pay more coupon interest, but the additional default risk is unacceptable for determining the contingent cost of liquidating all benefit obligations for contract cost accounting. The Board also believes that the criteria proposed in the NPRM permits less stringent interest rate criteria than the PPA. The final rule requirement for ''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,'' supports consistency and is less likely to engender disputes. The ANPRM criteria relied upon GAAP requirements, which must reflect the expected rates at which the pension benefits could be effectively settled. The criteria used in this final rule, which is the slightly more stringent than the criteria proposed in the NPRM, should also satisfy the GAAP requirements.

The provisions of 9904.412–50(b)(7)(iii)(B) allows the contractor to elect to use investment grade corporate bond yield rates ''published or defined by the Secretary of the Treasury for determination of the minimum contribution required by ERISA'' as its established cost accounting practice for setting the interest to be used for 9904.412–50(b)(7)(iii)(A) purposes. This permits the PPA yield curve to be used as a ''safe harbor.'' The 9904.412–50(b)(7)(iii)(A) criteria is consistent with, although less stringent than, the discount rate used to compute the accrued benefit obligation as described by GAAP which refers to ''high quality'' (*e.g.,* Moody's Aa or higher) corporate bonds.

Because all other assumptions must be based on best estimate assumptions that reflect long-term trends in accordance with 9904.412–50(b)(4), this provision will preclude the use of the ''most valuable'' benefit assumptions, *i.e.,* most conservative assumptions used to value the funding target for an ''at risk'' plan, unless there is a persuasive actuarial study that supports such assumptions as appropriate based on the past experience and future expectations for the plan. All other actuarial assumptions are also required by 9904.412–50(b)(7)(iii)(D) to be the same as the assumptions used to compute the actuarial accrued liability on a going concern basis. Also, CAS 412 generally requires that the plan's liability be based on the terms of the written plan document, whereas GAAP requires that patterns of benefit improvements and other features of the ''substantive plan'' be recognized. These differences in the basis for measuring the liability for ERISA's funding target and GAAP's accrued benefit obligation can cause variances between those values and the minimum actuarial liability. Therefore the Board believes the automatic adoption of ERISA's funding target or GAAP's accrued benefit obligation is inappropriate.

Topic 3: Suggested Alternative Means of Achieving Harmonization

Comments: Several commenters continue to recommend that the Board replace the going concern basis for liability measurement with the current mark-to-market measurement adopted by Congress for the PPA, and by the Financial Accounting Standards Board for financial statement reporting and disclosure. These commenters believe that issues unique to contract cost accounting can be addressed through existing or modified provisions, *e.g.,* volatility might be addressed through longer amortization periods for contract costing purposes.

There were differing views presented as to whether the CAS should directly reference ERISA and GAAP liabilities or simply establish a mark-to-market measurement basis. Proponents of direct reference believed that direct adoption of ERISA or GAAP values would permit contractors and auditors to rely on values already subject to review by the Internal Revenue Service (IRS) or independent audit. However, the opponents of this approach noted differences in the criteria concerning assumptions and events that must be recognized, such as ''at risk'' status under ERISA or anticipation of plan changes that may occur under GAAP.

One commenter was concerned with switching back to a going concern liability basis when the ERISA or GAAP liability was fully funded. Besides the potential for complexity, the concern was that the proposed rule would impose a requirement to fund a contract cost for pensions in a period in which ERISA would have a lesser minimum required contribution or GAAP would recognize a lower pension expense.

Another commenter agreed that the Board should recognize the mark-to-market based liability, but recommended that the current going concern measurement basis be phased out over a five-year transition period. The commenter believed that once the entire transition period was completed, then contract cost accounting should rely solely on the mark-to-market based liability.

A different alternative to pension harmonization suggested by one commenter would be to retain exclusive use of the going concern basis for measuring pension liability, but allow the difference between the going concern actuarial accrued liability and the mark-to-market minimum actuarial liability during the initial year of harmonization to be amortized as the costs of a transitional ''special event.'' This commenter believes that this approach would greatly simplify harmonization while permitting the previously unrecognized portion of the mark-to-market liability to be included in contract costs.

The third alternative approach suggested came from a commenter who believed that the CAS should retain the going concern basis for measuring the liability, but that any excess of the ERISA minimum required contribution over the contract cost would be amortized over a relatively short period, such as a five-year period. This commenter also argued that certain contractors, whose business is predominantly from cost-based Government contracts, be permitted to recognize the full excess in the current period because they do not have a sufficient business base to subsidize the excess during the amortization period.

Response: The Board reiterates its belief that absent evidence to the contrary, defined benefit plans are ongoing commitments, and therefore contract costing should reflect the average cost based on expected average asset returns in the future. However, the Board believes that the mark-to-market liability must be recognized as a minimum value in order to reflect the risk that the pension plan may have to settle its liability for pension benefits. The suggested alternative for amortizaton of the initial excess of the minimum actuarial liability over the actuarial accrued liability might reduce the accumulated value of prepayment credits, but during extended periods of low bond rates, substantial prepayment credits could again accumulate.

The Board does not believe that the suggested amortizing of the PPA minimum required contribution in excess of the going concern pension cost is a viable solution. Adding such amortization to the current computations of CAS 412 and 413 adds complexities, whereas the going concern based pension cost does adjust to the PPA minimum required contribution over a period of time. The simplier approach of adopting the PPA minimum required contribution, but using a smoothing mechanism, was one of the many options included in the Staff Discussion Paper, but it was ultimately rejected by the Board due to concerns that minimum funding might not achieve adequate funding in every economic environment.

Topic 4: Proposed Accelerated Gain & Loss Amortization

Comments: Two commenters expressed their support for the proposed accelerated amortization of actuarial gains and losses over a ten-year period instead of the current fifteen-year period. As one commenter stated:

> We also believe the change in amortization period for actuarial gains and losses from a fifteen-year to ten-year period, while longer than the seven-year amortization period used for PPA, provides a reasonable balance between timely cost recovery and an acceptable level of volatility for pension costs measured for CAS.

However, one commenter objected to the imposition of an amortization period that exceeded the amortization period required for the ERISA minimum required contribution. This commenter was concerned that the minimum required contribution would not be fully recognized for CAS purposes for a decade.

In response to the Board's inquiry concerning whether there should be special recognition of a gain or loss from an exceptional event, two commenters opined that this issue was not directly tied to harmonization and should be addressed in a separate case. Another commenter expressed their belief that ''the proposed NPRM retains effective smoothing mechanisms for gains and losses, so alternative rules for exceptional gains or losses are unnecessary.'' They were also concerned about the introduction of a new issue this late in the promulgation process.

Two commenters found confusing the proposed language added to 9904.412–50(a)(1)(v) and 9904.412–50(b)(7) regarding the adjustment to the actuarial accrued liability based on the minimum actuarial liability. They asked for clarification of the Board's intent.

Response: The Board agrees that the wording of proposed 9904.412–50(a)(1)(v) should be further clarified. The adjustment language of the proposed 9904.412–50(a)(1)(v) was intended to identify the portion of the period gain or loss attributable to the change in liability measurement basis. The adjustment language was used in the proposed 9904.412–50(b)(7) to tie the gain and loss provision and the proposed 9904.412–64.1 transitional provisions together.

In the final rule, the proposal at 9904.412–50(a)(1)(v) of the NPRM for a specific adjustment of the actuarial accrued liability to become the minimum actuarial liability, or the normal cost to become the minimum normal cost, is no longer used and has been deleted. Paragraph 9904.412–50(b)(7)(ii) of the final rule provides for a direct computation of the minimum actuarial liability and minimum normal cost.

The Board understands that standard actuarial practice is to measure the expected unfunded actuarial liability by updating the unfunded actuarial liability from the prior period for interest and expected demographic changes. The current period experience gain or loss is simply the difference between the actual and expected unfunded actuarial liability. The normal gain and loss measurement will include the effects of a switch between bases for measuring the liability. The gain and loss measurement, when the measurement basis changes, is illustrated at 9904.412–60.1(d).

The adjustment language has been deleted from the transition rule at 9904.412–50(a)(1)(v) and 9904.412–50(b)(7). The provisions of 9904.412–64.1 have been revised to address the scheduled phase in of the mark-to-market based minimum actuarial liability and minimum normal cost, and govern only the first five cost accounting periods of the Pension Harmonization Rule Transition Period.

The amortization of the experience gain or loss that occurs between the prior and current valuations is an element of the current period cost. The gain or loss is measured as the difference between the expected and actual unfunded actuarial liability as of the valuation date. Although the source of the gain or loss is the actuarial experience during the prior period, the amortization installment of the gain/loss is included in the determination of the current year cost together with amortization of the other bases. To avoid any disputes, 9904.412–64.1(b)(5) has been added to clarify that the gain or loss measured in the First Cost Accounting Period of the Pension Harmonization Rule Transition Period, which is the first cost accounting period this final rule is applicable, shall be amortized over a ten-year period.

Topic 5: General References to ERISA

Comment: Two commenters believe that the general references to ERISA in the proposed rule should be modified to cite specific provisions of ERISA. They are concerned that confusion or disputes may arise because of the numerous provisions that form ERISA. They also note that many of the provisions that affect pension contribution requirements and limitations are addressed by 26 U.S.C. 401 through 436, which implement the tax treatment of the contribution amount.

In particular, one commenter was concerned the general reference to ERISA in 9904.412–50(b)(5) and Illustration 9904.412–60(b)(3) might not provide adequate guidance regarding the projection of increases in benefits that are not based on salaries and wages. The commenter wrote the following regarding 9904.412–50(b)(5):

> In my opinion, the reference above to ''ERISA'' is tied to the current ERISA Tax Deductible Limit as defined in the Pension Protection Act of 2006. The Act Title VIII, Pension Related Revenue Provisions, added section 801 which amended Internal Revenue Code [at 26 U.S.C.] Section 404 to increase the Tax Deductible Limit for Single Employer plans. These rules became effective in 2008. The above ERISA reference should be clarified to my interpretation since ERISA also has numerous provisions tied to Minimum Funding rules.

This commenter also suggested that the reference to ERISA in 9904.413–50(c)(12)(viii) should be clarified:

> Under (viii), in my opinion the requirement is tied to the new Internal Revenue Code [26 U.S.C.] Section 436 mandated cessation of benefit accruals due to funding target attainment percentage. This section was created by the Pension Protection Act of 2006 and should be clarified.

Response: The Board agrees that the references to ERISA proposed in the NPRM require that the user ascertain the relevant U.S.C., Title 26 provision. The Board reiterates its precept that tax accounting is inappropriate for contract costing. The Board continues to believe that replacing the general references to ERISA with specific U.S.C., Title 26 provisions is not desirable because it might require frequent updates to CAS 412 and 413 to the extent that ERISA and Title 26 of the U.S.C. are amended in the future. The Board acknowledges that the tax deductibility of pension contributions is governed by the IRC at Title 26 of the U.S.C, and has made conforming technical corrections to the existing and proposed rules in the promulgation of this final rule.

The Board agrees that the general reference to ERISA in 9904.412–50(b)(5) might create confusion as to the applicable provision of ERISA. In this case the provision was intended to refer to section 801(a) of the PPA, which is implemented by 26 U.S.C. 404(o)(3)(A)(ii)(II). To avoid confusion and disputes concerning the relevant ERISA coverage, the Board has replaced the general reference to ERISA with specific provisions that parallel 26 U.S.C. 404(o)(3)(A)(ii)(II).

This new language does not indicate a loosening of the restrictions on recognizing the costs for contingencies. Certain reasonably foreseeable contingencies, such as salary increases, may be recognized in contract costing. CAS 412 has always permitted the projection of a contingent liability for future salary increases but subject to the requirement that actuarial assumptions must be individually reasonable based on future expectations and grounded by past experience. Like 26 U.S.C. 404(o)(3)(A)(ii)(II), this final rule limits the basis for projection of the contingent liability for flat benefit increases to the historical data from the last six years, and adds the restriction that the benefits must be provided under a collective bargaining agreement. The formality of collective bargaining negotiations and agreements will provide verifiable evidence of the pattern of benefit improvements because such evidence may be lacking or subject to dispute in less formal situations.

Regarding the general reference to ERISA in 9904.413–50(c)(12)(viii), the Board is not adopting a specific concept from ERISA, but instead is providing an exemption for involuntary benefit curtailments imposed by an outside authority, *i.e.,* ERISA. Use of a general reference to ERISA in this provision allows the 9904.413–50(c)(12)(viii) exemption to continue to reflect benefit curtailments required by ERISA without requiring CAS 412 and 413 to be amended for future changes in ERISA. Moreover, this is neither a measurement nor a period assignment provision; rather, 9904.413–50(c)(12) requires an immediate adjustment of the unfunded actuarial liability or actuarial surplus when specific events occur, which are defined as a segment closing, benefit curtailment, or plan termination. The purpose of 9904.413–50(c)(12)(viii) is to provide an exemption from an otherwise required immediate adjustment.

Under the current ERISA provision, the contractor can provide that benefit accruals will automatically resume if the plan's funding level sufficiently improves within 12 months. If the funding level takes longer to improve, the contractor can amend the plan to reinstate the accruals once the plan attains an adequate level of funding. Because the contractor has not unilaterally decided to change the pension plan (from an ongoing plan that grants and accrues benefits for matching contract service to a frozen state where there is no expectation of future accruals), the Board believes an immediate settlement, or true up, of assets and liabilities is inappropriate and unnecessarily disruptive to contract pricing.

It is noteworthy that 9904.413–50(c)(12)(viii) was derived from the aforementioned ERISA provision which permits the restoration of benefit accruals if the required funding level is attained within 12 months. Otherwise, under the ERISA provision, a plan amendment would be required to restore the missed accruals, which would require amortization in accordance with 9904.412–50(a)(1)(iii). Under the amendments for the CAS Pension Harmonization Rule, the contractor can elect to continue to accrue benefits that are expected to be reinstated, and thereby continue to match the pension cost with the underlying activity. If the pension plan does not automatically restore the missed accruals, then the future reinstatement of the missed accruals is contingent upon future action by the contractor, and cannot be recognized until and unless the plan is amended to restore the missed benefit accruals.

In reviewing this provision for inclusion in the final rule, the Board considered whether the ''ERISA missed accrual'' was a liability to be recognized by the normal cost under CAS, which is the measurement of the actuarial present value of the annual benefit accrual. The Board has revised this provision to ensure that there is a strong expectation that benefit accruals will be incurred. First, the employee's right to the restoration of the benefit accrual must be included in the written plan documents. (See 9904.413.50(c)(12)(viii).) Second, the contractor cannot elect to anticipate the future accruals if there is evidence to the contrary, *e.g.,* there is consideration of eliminating the restoration provision by plan amendment or the entity is facing bankruptcy due to serious financial difficulties. Finally, as with all pension costs assigned to a current period, the pension cost must be funded by the contractor to be allocable, and thereby allowable, for reimbursement by the Government through contract pricing. Reimbursement to the contractor by the Government of its allocable share of the funded pension cost attributable to the ''ERISA missed accrual'' provides a funding source to improve the plan's funding level, which directly supports the goal of the PPA.

Topic 6: Proposed Accounting for Prepayments

Comments: Some commenters objected to the proposed revision to 9904.412–30(a)(23) and 9904.412–50(a)(4), which would adjust the prepayment credits based on investment returns and administrative expenses in accordance with 9904.413–50(c)(7). The commenters agreed that expenses associated with investment management are properly charged against the prepayment credits because the prepayments are part of the invested assets. However, the commenters believed that expenses associated with benefit administration should not be charged against prepayment credits which have not been allocated to benefit liability. As one public commenter explained:

> We have several comments concerning proposed section 412–50(a)(4) which states that accumulated prepayment credits are to be adjusted for investment returns and administrative expenses. It seems reasonable to us that a proportional share of investment returns and investment related expenses should be allocated to the prepayment credit account, as a prepayment credit represents plan assets. As such, we agree that the prepayment credit should be allocated a proportional share of investment related administrative expenses. On the other hand, it does not seem reasonable that the prepayment credit should receive an allocation of any non-investment related administrative expenses (*e.g.,* for items such as plan administration, actuarial fees, and ERISA audits)—these types of expenses are not typically based on asset size, and the existence of a prepayment credit will not generally affect these fees.

To avoid confusion, one of the commenters recommended that 9904.412–30(a)(23) ''explicitly provide that the average rate of investment return for a year can be used to adjust all cash flows occurring in that year. This would eliminate the possibility that an auditor might require a contractor to measure investment returns within a plan year, which would be a difficult and expensive task.''

Several commenters believed that illustrations, in which the application of prepayment credits to fund the current pension cost on the first day of the plan year, might be misconstrued to be a cost measurement rule that might affect the allowability of interest on prepayment credits.

Two commenters were also concerned that the illustrations, in which the prepayment credits are accounted for separately from the segment accounting, might be read to require such accounting for prepayment credits. They believed that it was the contractor's prerogative to set the accounting practice on whether prepayment credits are identified by segment. Furthermore, they believe such a rule governing the accounting for prepayment credits was beyond the scope of harmonization.

Response: The Board understands that benefit-related expenses, such as PBGC premiums, fees for processing benefit payments, *etc.,* might not be directly associated to prepayment credits that have not been allocated towards the funding of benefits. The Board is concerned about the additional effort that would be required, and the potential for disputes, if contractors were required to separately identify administrative expenses as either investment-related or benefit-related. Furthermore, the Board views the monies deposited into the pension assets as fungible, *i.e.,* not individually identifiable. Besides, the Board notes that the PPA, as implemented by 26 U.S.C. 430(f)(8), adjusts the prefunding balance—which is the ERISA equivalent of the prepayment credit—at the rate of return on plan assets taking into account ''all contributions, disbursements, and other plan payments during such period.''

Topic 7: Actuarial Value of Assets

Comments: Three public comments questioned why the Board did not propose, as part of pension harmonization, the adoption of the PPA asset averaging method and 10% corridor around the market value of assets. The commenters believed that the proposed rule should have permitted adopting the PPA asset averaging method as part of the harmonization change so that the impact of the change in asset valuation method would be includable in the equitable adjustment claim. One commenter suggested that the 20% asset corridor be maintained to address the concerns with volatility.

One commenter questioned the illustration that implies a requirement that the prepayment be subtracted from the market value of assets before determining the actuarial value of assets as a requirement. In contrast the commenter noted that minimum funding requirements include the ERISA prefunding balance (prepayment) in the determination of the asset corridor. They asked that the Board clarify its intent and the proper treatment of the prepayment credit in the determination of the actuarial value of assets.

Response: The method of measuring the average value of assets (actuarial value of assets) under the PPA limits the expected rate of return on assets to the lower of the assumed rate of return on assets or the PPA interest rate for third segment. This limitation understates expected investment return when the prevailing yield curve rates are lower than the going concern expectations. However, the PPA average value of assets is not limited when the prevailing yield curve rates exceed the going concern expectations. The PPA average value of assets does not give equal treatment to gains and losses. When the PPA interest rates are lower than the going concern assumption, the required suppression of the expected return in investments can introduce an additional element of asset loss (or reduced gain) by understating the actuarial value of assets that would be developed on a going concern basis. However when the PPA interest rates are higher than the going concern assumption, there is no limit on the recognition expected investment earnings or losses. This added element of additional asset loss (or reduction in asset gain) does not comply with 9904.413–50(b)(2), which requires that the actuarial value of the assets ''be determined by 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.'' The conditional limitation of the actuarial value of assets can also add some volatility and difficulty in forward pricing projections. And finally, the traditional equal recognition of gains and losses allows the contractor to follow its own decisions concerning investment policy without penalty for gains in excess of the current corporate bond rate. The Board believes that the existing provisions regarding the actuarial value of assets permit a wide variety of reasonable asset valuation methods to be used. A contractor may elect to use a 2-year asset averaging method with a 10% corridor around the market value of assets, but switching to such a method is not required to achieve harmonization.

The accounting for the prepayment credit in a separate side account is an example in the NPRM of a possible methodology for measuring the actuarial value of assets. And as explained above, any reasonable asset valuation method may be used as part of a consistently applied cost accounting practice. The Board does not believe any further modification to the rule, including illustrations, is necessary.

Topic 8: Discounting of Contributions Receivable

Comments: One public commenter asked the Board to clarify the proposed 9904.413–50(b)(6)(i) requiring contributions receivable to be discounted to the beginning of the cost accounting period at the applicable effective interest rate.

Response: The PPA requires that contributions made after the end of the plan year be adjusted for interest based on the ''effective interest rate.'' The PPA defines the ''effective interest rate'' as the single interest rate that will produce the same present value of accrued benefits as the duration-specific corporate bond yield rates. In reviewing the relationship of interest adjustments under the proposed harmonization rule to the Board's conceptual framework for harmonization and contract cost accounting, the Board believes the proposed rule was internally inconsistent. The general guiding principle for contract costing under harmonization is that the assumed interest rate, based on expected rates of return on investments, shall be used for all measurement purposes except the measurement of the minimum actuarial liability and minimum normal cost under 9904.412–50(b)(7)(ii).

Under the final rule, pension costs would be adjusted to the date of funding. Accumulated balances under 9904.412–50(a)(2) and amortization installments under 9904.412–50(a)(1) would be determined based on the assumed interest rate. Adjusting contributions receivable at the current corporate bond rate, which may not be representative of the expected earnings on the pension fund, is inconsistent with the assumed interest used for other measurements. Therefore, the Board has modified 9904.413–50(b)(6) to require that all contributions receivable be adjusted based on the assumed interest rate.

The harmonization rule adjusts amounts that have been deposited into the pension fund at the net rate of return on plan investments for the period.

Topic 9: Assignable Cost Limits

Comments: Some commenters recommended that the Board restore the ANPRM proposal for a buffer on the assignable cost limitation. The commenters did note that the 25% buffer proposed in the ANPRM was too large, and suggested that a 10% buffer would be sufficient to promote predictability while not permitting the accumulation of an excessive surplus.

Response: The Board recognizes that permitting a reasonable buffer in the assignable cost limitation has the advantage of dampening cost volatility for forward pricing purposes when the plan funding is close to the limit. However, the Board remains concerned that use of a buffer may result in the accumulation of excessive surplus assets. Currently the 9904.412–50(c)(2)(i) provision prohibiting the assignment of negative pension costs inhibits the Government's ability to recover an excessive asset surplus. Addressing the buffer concept and changing the zero dollar floor (9904.412–50(c)(2)(i)) are beyond the scope of harmonization. The Board believes these issues require further research because recognizing amounts in excess of measured cost has no precedent in the Cost Accounting Standards. The issue of excessive assets and the inclusion of a buffer in the assignable cost limitation must be considered together should the Board decide to open a new case on segment closing and other such adjustments.

Topic 10: Segment Closings and Benefit Curtailments

Comments: Many commenters objected to the proposed exclusion of the minimum actuarial liability from recognition for segment closings and benefit curtailment purposes under 9904.413–50(c)(12)(i). The commenters advised the Board of their strong belief that the proposed exclusion of the minimum actuarial liability in measuring the segment closing adjustment effectively reversed the CAS Pension Harmonization Rule. One public commenter summarized the objection as follows:

> The NPRM currently requires segment closing calculations to use the unadjusted Actuarial Accrued Liability (AAL), or the ongoing liability currently applicable in the existing CAS rules. We believe that the more appropriate measure of the liability in a segment closing calculation is the Minimum Accrued Liability (MAL) to achieve harmonization. The MAL, by its nature, is intended to reflect the present value of a pension plan if its obligations were settled at a particular point in time (*i.e.,* the segment closing date), while the AAL is reflective of an ongoing plan by incorporating long-term liability assumptions. The application of the AAL at segment closing effectively reverses the impact of harmonization that may have applied in prior periods since the final true-up of plan costs will revert back to the current (non-harmonized) CAS rules. We believe this is a fundamental flaw of the current NPRM that must be modified to ensure harmonization is achieved in the spirit of the mandate within the Pension Protection Act.

The following public commenter addressed the acceptance of risk by the contractor's decisions to settle or retain the benefit liability at segment closing:

> Looking from a theoretical standpoint, a segment closing should be based on a relatively risk-free basis, which essentially calls for the MAL to be used. If a contractor wishes to assume risks inherent in the investment of assets on a greater risk basis, then the contractor should absorb any losses as well as any gains that might arise.

Another commenter noted the relationship between the market value of assets, which is required in the measurement of the segment closing adjustment, and the minimum actuarial liability, which is not recognized:

> In order to harmonize pension cost, benefit curtailment and segment closing adjustments should be based on the difference between the Market Value of Assets (MVA) and the MAL. Both the MVA and the MAL are market-based measurements of the pension plan assets and obligations at the prevailing market conditions, and this basis is consistent with the requirements of the PPA.

One commenter asked that, in addition to mandatory benefit curtailments, voluntary benefit curtailments also should be exempted from the adjustment requirements of 9904.413–50(c)(12). The commenter argued that the required adjustment was disruptive and unnecessary if the segment was continuing and pension costs would continue to be charged to the contract.

There were three public comments concerning the proposed accounting for 9904.413–50(c)(12) adjustments in subsequent periods. These comments recommended revisions to the wording of 9904.413–50(c)(12)(ix). One commenter believed that the Board should consider addressing, in a future case on segment closings, subsequent actuarial gains for which the recovery of any excessive asset surplus is limited by the zero-dollar floor of 9904.412–50(c)(2)(i).

Response: The Board limited its proposed amendment to 9904.413–50(c)(12) to the exemption of benefit curtailments mandated by ERISA. Currently such benefit curtailments are addressed by 26 U.S.C.436. The Board recognizes that there are issues concerning the risks and rewards of settling or retaining the benefit liability upon the occurrence of a segment closing or benefit curtailment. There is also a potential that an analysis would demonstrate that the risks and rewards will vary depending upon market and economic conditions at the time of the segment closing or benefit curtailment.

The Board believes that any changes to the current provisions of 9904.413–50(c)(12), including the provision at 9904.413–50(c)(12)(ix) that was proposed in the NPRM, must be based on a full consideration of these issues. Unintended consequences might arise if all the issues are not fully vetted. The Board believes that the issues and problems with the current segment closing and benefit curtailment provisions are beyond the scope of pension harmonization required under section 106, and should be addressed in a separate case, which the Board is considering. Accordingly, the Board has deleted the proposed provision at 9904.413–50(c)(12)(ix) from the final rule.

In reviewing the relationship of the segment closing liability to the liability used to compute annual pension costs, the Board noted that transfers of participants to other segments, including inactive segments, might be an integral part of winding down a segment's workforce prior to a segment closing. To fully respond to the public comments, the Board considered whether the asset transfers associated with participant transfers should be based on the same liability as used for 9904.413–50(c)(12) purposes, that is, the actuarial accrued liability determined under the accrued benefit cost method rather than the contractor's normal funding method. In the preamble to the 1995 amendments to CAS 412 and 413 (60 FR 16534, March 30, 1995), the Board noted that it was adding this distinction for the liability to be used to transfer assets because of its relationship to segment closings:

> Under the revised definition of a segment closing, some employees may remain in a segment performing non-Government work while other employees may be transferred to other segments. For consistency, the provisions for transfers of either active or retired participants specify that the assets transferred must equal the actuarial accrued liability determined under the accrued benefit cost method.

Therefore, the Board believes that to be consistent with the exemption of 9904.413–50(c)(12) from 9904.412–50(b)(7), the liability to be used to transfer assets under 9904.413–50(c)(8) and (9) should be likewise exempt. While participant and associated assets transfers also effect the measurement of ongoing pension costs, the Board believes that this treatment has the additional benefit of preserving assets within the segment in which they were accumulated. In the 1995 preamble, the Board explained its view on the impact of future costs of participant and associated asset transfers:

> If plan participants remain employed by the contractor, whether in the same or another segment, the Board believes the responsibility for future salary increases, which are attributable to future productivity, merit, and inflation, belongs to the future customers that benefit from the participants' continued employment.

Furthermore, because asset transfers under 9904.413–50(c)(8) and (9) are based on the liability measured by the accrued benefit cost method, rather than the established funding method, the Board has added to these paragraphs clarifying language regarding which actuarial assumptions are appropriate. This clarification was not previously necessary because all assumptions were required to reflect long-term trends.

Topic 11: Illustrations

Comments: Two commenters recommended that the Board eliminate proposed harmonization illustrations that ''do not focus on unique features of the rule and that could imply acceptance of tax accounting.'' They believed that, not only were the portions of the illustration related to ERISA measurements unnecessary, as ERISA is amended in the future, these illustrations could also become confusing and obsolete.

Response: The Board agrees and has limited the harmonization illustrations to those that demonstrate the measurement and assignment of the pension cost under this final rule.

Topic 12: Transition Rule

Comments: The comments from the industry associations were supportive of the proposed 9904.412–64.1 transition rule:

> We understand the transition rules are intended to mitigate any abrupt increase in costs as a result of the final rules to allow the Government to manage agency budgets. We continue to agree that this is an important reason to use such a transition and support the duration selected. In addition, we believe the phase-in will reduce the monetary amounts and number of equitable adjustments resulting from this required change in CAS, thereby lessening the opportunities for disagreements.

The associations believed that their support for the proposed rule and the transition provision was demonstrated by their acceptances of a further delay in the timeliness of cost recovery and prolonged negative cash flow burden. Other commenters were also supportive of the proposed transition.

However, two commenters believed that it was inappropriate for the Board to propose a transition rule to address the Government's budgetary concerns. One commenter opined that:

> * * * [there] will be significant gaps between CAS pension costs and the PPA funding requirements, gaps that do not exist for businesses selling commercially. These gaps will have detrimental cash flow and profit impacts on contractors because they will be required to fund shortfalls over a shorter period than they will be able to recover associated costs from the Government.

The other commenter believed it was appropriate to include the proposed transition to allow both parties to the contract a means of managing the forward pricing process and equitable adjustments from the expected large change in pension costs.

On the other hand, a joint public comment from several of the Government's military agencies expressed their belief that the magnitude of the potential pension cost increases requires a longer transition period in order to properly manage the impact on budgets and existing contracts.

Response: The Board determined that a transition period was necessary to implement the CAS Pension Harmonization Rule in a fair and equitable manner, as it has done with previous promulgations. In any attempt to promote fairness and equity, the Board would necessarily take into account the nature of the Government acquisition process, which includes the budgetary process. The Board believes that this transition period was necessary to allow the cost impact of this final rule to be gradually recognized in the pricing and costing of CAS-covered and FAR-covered contracts alike. It also moderates the difference in the pension cost allocable to FAR-covered fixed price contracts entered into prior to the effective date of the CAS Pension Harmonization Rule that are not subject to equitable adjustment.

Topic 13: Effective Date of the Final Rule and Its Applicability to Contracts

Comments: Many contractors recommended that the Board allow sufficient time to modify cost projections and permit contract cost negotiation to accommodate the change in accounting practice that would be required by the final rule. There was general agreement that the final rule should not be effective prior to January 1, 2011, and that the effective date should be delayed for 60 days from the publication of the final rule. Some of the commenters noted that delayed effective and applicability dates might ease the impact of equitable adjustments.

Response: The Board has considered the comments regarding the effective date of the final rule. This final rule is being published after January 1, 2011, which is later than the effective date mandated by section 106 of the PPA, but provides the relief requested in the public comments to delay the effective and applicability dates. The Board decided to delay the effective date for 60 days after publication to permit time for contractors to make the necessary changes to the actuarial valuation and cost projection systems. Furthermore, to ensure that no contractor becomes immediately applicable to the final rule, the implementation date is the first cost accounting period after June 30, 2012. The Board agrees that such a delay will eliminate a portion of the equitable adjustment claims for contractors that report on a calendar year basis.

Topic 14: Guidance on Equitable Adjustments

Comments: Two commenters requested that the Board provide guidance on the calculation of the cost impact for equitable adjustment. The commenters believed such guidance was important to avoid having different interpretations that would lead to disputes over equitable adjustments. One of the commenters asked that the Board explicitly identify what constitutes a mandatory cost accounting practice change due to the CAS Pension Harmonization Rule.

Response: The Board believes that the final rule changes cost accounting practices contained in CAS 412 and 413 that are necessary to implement the CAS Pension Harmonization Rule required by section 106 of the PPA. Whether a particular accounting practice has changed, the actual determination of the cost impact and the processing of equitable adjustments are matters for CAS administration as may be undertaken by the contracting parties for CAS-covered contracts. Therefore, this final rule is limited to contract cost accounting and does not include any guidance on the administration of the change in cost accounting practice; the Board urges the Federal agency heads to issue the necessary policies and procedures.

Topic 15: Request for Additional Opportunities for Public Comment

Comments: Several commenters recommended that the Board republish the CAS Pension Harmonization Rule as a second NPRM if substantive changes are made to the rule. The commenters believed that a second NPRM would be advantageous given the complexity and cost impact of the proposed changes.

Response: The Board believes that the conceptual basis that underpinned the NPRM has been extended to the final rule. While the elimination of the threshold criteria of ''trigger 1'' and ''trigger 3'' have greatly reduced the wording and complexity of 9904.412–50(b)(7), the basic concepts for establishing a harmonization prerequisite have not changed. This final rule does not add any substantive changes to how the CAS Pension Harmonization Rule is implemented. Therefore, the Board believes that a second NPRM is not necessary, and after consideration of the public comments to the NPRM, the Board is publishing the CAS Pension Harmonization Rule as a final rule.

D. Paperwork Reduction Act

The Paperwork Reduction Act, Public Law 96–511, does not apply to this final rule because this rule imposes no additional 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 final rule are those normally maintained by contractors and subcontractors who claim reimbursement of costs under Government contracts.

E. Executive Order 12866, the Congressional Review Act, and the Regulatory Flexibility Act

Because the affected contractors and subcontractors are those who are already subject to CAS 412 and 413, the economic impact of the promulgation of this CAS Pension Harmonization Rule as a final rule on contractors and subcontractors is expected to be minor. As a result, the Board has determined that this final 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. For the same reason, the Administrator of the Office of Information and Regulatory Affairs has determined that this final rule is not a ''major rule'' under the Congressional Review Act, 5 U.S.C. Chapter 8. Furthermore, this final rule does not have a significant effect on a substantial number of small entities because small businesses are exempted from the application of the Cost Accounting Standards. Therefore, this final rule does not require a regulatory flexibility analysis under the Regulatory Flexibility Act of 1980, 5 U.S.C. chapter 6.

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 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. 111–350, 124 Stat. 3677, 41 U.S.C. 1502 [formerly Pub. L. 100–679, 102 Stat 4056, 41 U.S.C. 422].

■ 2. Section 9904.412–30 is amended by revising paragraphs (a)(1), (8), (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.)

* * * * *

(8) *Assignable cost deficit* means the increase in unfunded actuarial liability that results when the pension cost computed for a qualified defined-benefit pension plan exceeds the maximum tax-deductible amount for the cost accounting period determined in accordance with the Internal Revenue Code at Title 26 of the U.S.C.

(9) *Assignable cost limitation* means the excess, if any, of the actuarial accrued liability and 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 income and expenses in accordance with 9904.413–50(c)(7) 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 CAS Pension Harmonization Rule.'' However, paragraphs 9904.413–50(c)(8), (9) and (12) are exempt from the requirements of 9904.412–50(b)(7).

* * * * *

■ 4. In 9904.412–50, paragraphs (a)(2), (4) and (6); (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) * * *

(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 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 subsection.

(ii) Such portions of unfunded actuarial liability shall be adjusted for interest based on the interest assumption established 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 income and 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.

* * * * *

(6) For purposes of this Standard, defined-benefit pension plans funded exclusively by the purchase of individual or group permanent insurance or annuity contracts, and thereby exempted from the minimum funding requirements implemented by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.,* as amended, shall be treated as defined-contribution pension plans. However, all other defined-benefit pension plans administered wholly or in part through insurance company contracts shall be subject to the provisions of this Standard relative to defined-benefit pension plans.

(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 whose benefits are subject to a collectively bargained agreement(s) and whose benefits are not based on salaries and wages, the contractor may recognize benefit improvements expected to occur in succeeding plan years determined on the basis of the average annual increase in benefits over the 6 immediately preceding plan years.

* * * * *

(7) *CAS Pension Harmonization Rule:* For qualified defined benefit pension plans, the pension cost shall be determined in accordance with the provisions of paragraph (b)(7)(i) of this section.

(i) In any period that the sum of the minimum actuarial liability and the minimum normal cost exceeds the sum of the actuarial accrued liability and the normal cost, the contractor shall measure and assign the pension cost for the period in accordance with 9904.412 and 9904.413 by using the minimum actuarial liability and minimum normal cost as the actuarial accrued liability and normal cost, respectively, for all purposes unless otherwise excepted.

(ii) 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)(iii).

(B) The *minimum normal cost* shall be the normal cost measured under the accrued benefit cost method and using an interest rate assumption as described in 9904.412–50(b)(7)(iii). Anticipated administrative expense for the period shall be recognized as a separate incremental component of normal cost.

(iii) 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 and that are in the top 3 quality levels available, *e.g.,* Moody's' single ''A'' rated or higher;

(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 may be published by the Secretary of the Treasury and used for determination of the minimum contribution required by ERISA. The contractor's cost accounting practice includes the election of the specific published rate or set of rates and must be consistently followed;

(C) For purposes of 9904.412–50(b)(7)(ii)(A) and (B), use of 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 actuarial assumptions, other than interest 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) An amount of pension cost of a qualified pension plan, adjusted pursuant to paragraphs (c)(2)(i) and (ii) of this subsection that exceeds the sum of (A) the maximum tax-deductible amount, determined in accordance with the Internal Revenue Code at Title 26 of the U.S.C., and (B) 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 and 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 (6), (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 interest rate assumption, which is based on expected rate of return on investments and complies with 9904.412–40(b)(2) and 9904.412–50(b)(4), 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) and 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.

(i) Under the first plan, in which the benefits are not subject to a collective bargaining agreement, 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 for this first plan, the contractor may not assume future benefits greater than that currently required by the plan.

(ii) 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 not only benefits increases required by the collective bargaining agreement, but may also consider subsequent benefit increases based on the average increase in benefits during the previous 6 years in computing pension costs for the current cost accounting period in accordance with 9904.412–50(b)(5). The contractor shall limit projected benefits to the increases specified in the provisions of the existing plan, as amended by the collective bargaining agreement, 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 is measured by the minimum actuarial liability in accordance with 9904.412–50(b)(7)(ii) since the criterion of 9904.412–50(b)(7(i) has been satisfied. 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 2017, 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 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 2017 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, 2018, 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 a ten-year period beginning in 2018 in accordance with 9904.412–50(c)(2)(ii)(C) and 9904.413–50(a)(2)(ii).

(3) Assume the same facts shown in illustration 9904.412–60(c)(2), except that in 2016, 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 2016 and 2017, and was brought forward to 2017 in accordance with 9904.412–50(a)(2). Therefore, $216,000 ($200,000 × 1.08) is excluded from the amount considered fully amortized in 2017. The next year, 2018, 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 2017 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 limitation on tax-deductible contributions imposed by the Internal Revenue Code at Title 26 of the U.S.C., 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 2018 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 which was deposited on the first day of the plan year, Contractor K could apply up to $700,000 of the accumulated value of prepayment credits towards the pension cost computed for the period. In accordance with the provisions of 9904.412–50(c)(2)(iii), the amount of pension cost assigned to the current period shall not exceed $1,700,000, which the sum of the $1 million maximum tax-deductible amount and $700,000 accumulated value of prepayment credits. 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 sum of the $1 million contribution and $700,000 accumulated value of prepayment credits towards the $1.5 million assigned pension cost ($700,000 + $1,000,000 − $1,500,000). The $200,000 of remaining accumulated value of prepayment credits is adjusted for $14,460 of investment income allocated in accordance with 9904.412–50(a)(4) 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) and 9904.412–50(c)(1).

(6) Assume the same facts for Contractor K in 9904.412–60(c)(4), except that the 2017 assignable cost limitation is $1.3 million and the accumulated value of prepayment credits is $0. Pension cost of $1.5 million is computed for the cost accounting period, but the assignable cost is limited to $1.3 million in accordance with 9904.412–50(c)(2)(ii)(A). Pursuant to 9904.412–50(c)(2)(ii)(B), all existing amortization bases maintained in accordance with 9904.412–50(a)(1) are considered fully amortized. The assignable cost of $1.3 million is then compared to the maximum tax-deductible amount of $1 million. Pursuant to 9904.412–50(c)(2)(iii), Contractor K's assignable pension cost for the period is limited to $1 million. The $300,000 ($1.3 million − $1 million) excess of the assignable cost limitation over the tax-deductible maximum is assigned to future periods as an assignable cost deficit.

* * * * *

(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 an interest assumption of 8%, which is based on the expected rate of return on investments and complies with 9904.412–40(b)(2) and 9904.412–50(b)(4). 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 income and expenses in accordance with 9904.412–50(a)(4) and 9904.413–50(c)(7). Allocated earnings and expenses, and the prepayment credits, shall be excluded from the actuarial value of assets used to compute the next year's pension cost. For the current period the net return on assets attributable to investment income and expenses was 6.5%. Therefore, the accumulated value of prepayment credits of $5,325 (5,000 × 1.065) 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 Pension Harmonization Rule.

The following illustrations address the measurement, assignment and allocation of pension cost on or after the Applicability Date of the CAS Harmonization Rule. The illustrations present the measurement, assignment and allocation of pension cost for a contractor that separately computes pension costs by segment or aggregation of segments. The actuarial gain and loss recognition of changes between measurements based on the actuarial accrued liability, determined without regard to the provisions of 9904.412–50(b)7) and the minimum actuarial liability are illustrated in 9904.412–60.1(d). 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, of which some segments have contracts that are subject to this Standard and 9904.413, while other segments perform commercial work only. The demographic experience regarding employee terminations for employees of 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 in the aggregate and allocates the aggregate cost to segments on a composite basis. Inactive employees are retained in the segment from which they terminated employment. 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.

(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) and 50(b)(1), for measuring the actuarial accrued liability and normal cost. The contractor uses the accrued benefit cost method (also known as the unit credit cost method without projection) to measure the minimum actuarial liability and minimum normal cost. The accrued benefit cost method satisfies 9904.412–50(b)(7)(ii) as well as 9904.412–40(b)(1) and 50(b)(1).

(ii) *Interest Rates:* (A) Assumed interest rate used to measure the actuarial accrued liability and normal cost: The contractor's basis for establishing the expected rate of return on investments assumption satisfies the criteria of 9904.412–40(b)(2) and 9904.412–50(b)(4). This is referred to as the ''assumed interest rate'' for purposes of this illustration.

(B) Corporate bond rate used to measure the minimum actuarial liability and minimum normal cost: For purposes of measuring the minimum actuarial liability and minimum normal cost the contractor has elected to use a specific set of investment grade corporate bond yield rates published by the Secretary of the Treasury for ERISA's minimum funding requirements. The basis for establishing the set of corporate bond rates meets the requirements of 9904.412–50(b)(7)(iii)(A) as permitted by 9904.412–50(b)(7)(iii)(B). This set of rates is referred to as the ''corporate bond rates'' for purposes of this illustration.

(iii) *Mortality:* The mortality assumption 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)(2) which requires assumptions to ''represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations.'' The specific table used for each valuation shall be identified.

(iv) *Termination of Employment:* The termination of employment (turnover) assumption is based on an experience study of Harmony Company employee terminations or causes other than retirement. Because the experience for Segment 1 was materially different from the experience for the rest of the company, the termination of employee assumption for Segment 1 was developed based on the experience of that segment only in accordance with 9904.413–50(c)(2)(iii). The termination of employment experiences for each of Segments 2 through 7 were materially similar, and therefore the termination of employee assumption for Segments 2 through 7 was developed based on the experiences of those segments in the aggregate.

(v) *Actuarial Value of Assets:* 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) *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 the pension plan, as well as Segment 1 and Segments 2 through 7, have unfunded actuarial liabilities and measures its pension cost for plan year 2017 as follows:

(1) *Asset Values:* (i) *Market Values of Assets:* The contractor accounts for the market value of assets in accordance with 9904.413–50(c)(7). The contractor has elected to separately identify the accumulated value of prepayment credits from the assets allocated to segments. The accumulated value of prepayment credits are adjusted in accordance with 9904.412–50(a)(4) and 9904.413–50(c)(7). The market value of assets as of January 1, 2017, including the accumulated value of prepayment credits, is summarized in Table 1.

TABLE 1—JANUARY 1, 2017, MARKET VALUE OF ASSETS

	Total plan	Segment 1	Segments 2 through 7	Accumulated prepayments	Note
Market Value of Assets	$14,257,880	$1,693,155	$11,904,328	$660,397	1

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

(ii) *Actuarial Value of Assets:* Based on the contractor's disclosed asset valuation method, and recognition of the asset gain or loss, which is the difference between the expected income, based on the assumed interest rate, which complies with 9904.412–40(b)(2) and 9904.412–50(b)(4), and the actual income, including realized and unrealized appreciation and depreciation for the current and four prior periods as required by 9904.413–40(b), is delayed and amortized over a five-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. The actuarial value of assets cannot be less than 80%, or more than 120%, of the market value of assets. The development of the actuarial value of assets for the total plan, as well as for

Segment 1 and Segments 2 through 7, as of January 1, 2017 is shown in Table 2.

TABLE 2—JANUARY 1, 2017, ACTUARIAL VALUE OF ASSETS

	Total plan	Segment 1	Segments 2 through 7	Accumulated prepayments	Note
Market Value at January 1, 2017	$14,257,880	$1,693,155	$11,904,328	$660,397	1
Total Deferred Appreciation	(37,537)	(4,398)	(31,400)	(1.739)	2
Unlimited Actuarial Value of Assets	14,220,343	1,688,757	11,872,928	658,658	
CAS 413 Asset Corridor 80% of Market Value of Assets	11,406,304	1,354,524	9,523,462	528,318	
Market Value at January 1, 2017	14,257,880	1,693,155	11,904,328	660,397	1
120% of Market Value of Assets	17,109,456	2,031,786	14,285,194	792,476	
CAS Actuarial Value of Assets	14,220,343	1,688,757	11,872,928	658,658	3, 4

Note 1: See Table 1.
Note 2: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.
Note 3: CAS Actuarial Value of Assets cannot be less than 80% of Market Value of Assets or more than 120% of Market Value of Assets.
Note 4: The Actuarial Value of Assets are used in determination of any Unfunded Actuarial Liability or Unfunded Actuarial Surplus regardless of whether the liability is based on the actuarial accrued liability measured without regard to 9904.412–50(b)(7) or minimum actuarial liability measured in accordance with 9904.412–50(b)(7).

(2) *Liabilities and Normal Costs:* (i) *Actuarial Accrued Liabilities and Normal Costs:* Based on the plan population data and the disclosed methods and assumptions for CAS 412 and 413 purposes, the contractor measures the actuarial accrued liability and normal cost on a going concern basis using an assumed interest rate that satisfies the requirements of 9904.412–40(b)(2) and 9904.412–50(b)(4). The actuarial accrued liability and normal cost for each segment are measured based on the termination of employment assumption unique to that segment. The actuarial accrued liability and normal cost for the total plan is the sum of the actuarial accrued liability and normal cost for the segments. The actuarial accrued liability and normal cost are shown in Table 3.

TABLE 3—ACTUARIAL ACCRUED LIABILITIES AND NORMAL COSTS AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
Actuarial Accrued Liability (AAL)	$16,325,000	$2,100,000	$14,225,000	1
Normal Cost	910,700	89,100	821,600	1
Expense Load on Normal Cost				2 1, 2

Note 1: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation. The actuarial accrued liability and normal cost are computed using the assumed interest rate in accordance with 9904.412–40(b)(2) and 9904.412.50(b)(4).
Note 2: Expected administrative expenses are implicitly recognized as part of the assumed interest rate.

(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 using a set of investment grade corporate bond yield rates published by the Secretary of the Treasury that satisfy the requirements of 9904.412–50(b)(7)(iii). The minimum actuarial liability and minimum normal cost for each segment are measured based on the termination of employment assumption for that segment. The minimum actuarial liability and minimum normal cost for the total plan is the sum of the actuarial accrued liability and normal cost for the segments as shown in Table 4.

TABLE 4—MINIMUM ACTUARIAL LIABILITIES AND MINIMUM NORMAL COSTS AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
Minimum Actuarial Liability	$16,636,000	$2,594,000	$14,042,000	1
Minimum Normal Cost	942,700	102,000	840,700	1
Expense Load on Minimum Normal Cost	82,000	8,840	73,160	1, 2

Note 1: Plan level information taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation and equals the sum of the data for the segments. Data for the segments is taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.
Note 2: Anticipated annual administrative expenses are separately recognized as an incremental component of minimum normal cost in accordance with 9904.412–50(b)(7)(ii)(B).

(3) *CAS Pension Harmonization Test:* (i) In accordance with 9904.412–50(b)(7)(i), the contractor compares the sum of the actuarial accrued liability and normal cost plus any expense load, to the sum of the minimum actuarial liability and minimum normal cost plus any expense load. Because the contractor separately computes pension costs by segment, or aggregation of segments, the applicability of 9904.412–50(b)(7)(i) is determined separately for

Segment 1 and Segments 2 through 7. See Table 5, which shows the application of the provisions of 9904.412–50(b)(7)(i), *i.e.,* the CAS pension harmonization test.

TABLE 5—CAS PENSION HARMONIZATION TEST AT JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)	(Note 2)	(Note 2)	
"Going Concern" Liability for Period:	....	....	....	3
Actuarial Accrued Liability	....	$2,100,000	$14,225,000	4
Normal Cost	....	89,100	821,600	4
Expense Load on Normal Cost	....	....	....	4, 5
Total Liability for Period	....	2,189,100	15,046,600	....
Minimum Liability for Period:				
Minimum Actuarial Liability	....	2,594,000	14,042,000	6
Minimum Normal Cost	....	102,000	840,700	6
Expense Load on Minimum Normal Cost	....	8,840	73,160	6, 7
Total Minimum Liability for Period	....	2,704,840	14,955,860	....

Note 1: Because the contractor determines pension costs separately for Segment 1 and Segments 2 through 7, the data for the Total Plan is not needed for purposes of the 9904.412–50(b)(7)(i) determination.

Note 2: Because the contractor determines pension cost separately for Segment 1 and Segments 2 through 7, the 9904.412–50(b)(7) CAS Pension Harmonization test is applied at the segment level to determine the larger of the Total Liability for Period or the Total Minimum Liability for Period. For Segment 1, the larger Total Minimum Liability for Period determines the measurement basis for the liability and normal cost. For Segments 2 through 7, the larger Total Liability for Period determines the measurement basis for the liability and normal cost.

Note 3: The actuarial accrued liability and normal cost plus any expense load are computed using interest assumptions based on long-term expectations in accordance with 9904.412–40(b)(2) and 9904.412–50(b)(4). For purposes of Illustration 9904.412–60.1(b), the sum of these amounts are referred to as the "Going Concern" Liability for the Period.

Note 4: See Table 3.

Note 5: Because the contractor's assumed interest rate implicitly recognizes expected administrative expenses there is no explicit amount added to the normal cost.

Note 6: See Table 4.

Note 7: The contractor explicitly identifies the expected expenses as a separate component of the minimum normal cost, as required by 9904.412–50(b)(7)(ii)(B).

(ii) As shown in Table 5 for Segment 1, the total minimum liability for the period (minimum actuarial liability and minimum normal cost) of $2,704,840 exceeds the total liability for the period (actuarial accrued liability and normal cost) of $2,189,100. Therefore, the contractor must measure the pension cost for Segment 1 using the minimum actuarial liability and minimum normal cost as the values of the actuarial accrued liability and normal cost in accordance with 9904.412–50(b)(7)(i). In other words, the contractor substitutes the minimum actuarial liability and minimum normal cost for the actuarial accrued liability and normal cost.

(iii) Conversely, as shown in Table 5 for Segments 2 through 7, the total liability for the period of $15,046,600 exceeds the total minimum liability for the period of $14,955,860 for Segments 2 through 7. Therefore, the contractor must measure the pension cost using the actuarial accrued liability and normal cost without regard for the minimum actuarial liability and minimum normal cost.

(4) *Measurement of Current Period Pension Cost:* (i) To determine the pension cost for Segment 1, the contractor measures the unfunded actuarial liability, pension cost without regard to 9904.412–50(c)(2) limitations, and the assignable cost limitation using the actuarial accrued liability and normal cost as measured by the minimum actuarial liability and minimum normal cost, respectively, which are based on the accrued benefit cost method. This measurement complies with the requirements of 9904.412–50(b)(7) and the definition of actuarial accrued liability, 9904.412–30(a)(2) and normal cost, 9904.412–30(a)(18).

(ii) To determine the pension cost for Segments 2 through 7, the contractor measures the unfunded actuarial liability, pension cost without regard to 9904.412–50(c)(2) limitations, and the assignable cost limitation using the actuarial accrued liability and normal cost based on the projected unit credit cost method, which is the contractor's established cost accounting method and the contractor's assumed interest rate based on long-term trends as required by 9904.412–50(b)(4).

(iii) Unfunded Actuarial Liability (Table 6):

TABLE 6—UNFUNDED ACTUARIAL LIABILITY AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Actuarial Accrued Liability	$16,819,000	$ 2,594,000	$14,225,000	2
CAS Actuarial Value of Assets	(13,561,685)	(1,688,757)	(11,872,928)	3
Unfunded Actuarial Liability	3,257,315	905,243	2,352,072	....

Note 1: Because the contractor determines pensions separately for Segment 1 and Segments 2 through 7, the values are the sum of the values for Segment 1 and Segments 2 through 7.

Note 2: For Segment 1, the actuarial accrued liability is measured by the accrued benefit cost method as required by 9904.412–50(b)(7), *i.e.,* the minimum actuarial liability as described in 9904.412–50(b)(7)(ii). See Table 4. For Segments 2 through 7, the actuarial accrued liability is measured by the projected unit credit cost method, which is the contractor's established actuarial cost method since these the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 3: See Table 2. The CAS Actuarial Value of Assets is used regardless of the basis for determining the liabilities. The CAS Actuarial Value of Assets allocated to Segment 1 and Segments 2 through 7 excludes the accumulated value of prepayment credits as required by 9904.412–50(a)(4).

(iv) Measurement of the Adjusted Pension Cost (Table 7):

TABLE 7—MEASUREMENT OF PENSION COST AT JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Normal Cost	....	$ 102,000	$821,600	2
Expense Load on Normal Cost	....	8,840	....	2, 3
Amortization Installments	....	140,900	366,097	4
Measured Pension Cost	1,439,437	251,740	1,187,697	....

Note 1: Because the contractor separately computes pension cost for Segment 1 and Segments 2 through 7, only the total pension cost is shown.

Note 2: For Segment 1, the normal cost is measured by the accrued benefit cost method as required by 9904.412–50(b)(7), *i.e.,* the minimum normal cost as described in 9904.412–50(b)(7)(ii). See Table 4. For Segments 2 through 7, the normal cost is measured by the contractor's established immediate gain cost method since these the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 3: Because the criterion of 9904.412–50(b)(7)(i) was met for Segment 1, the Normal Cost is measured by the Minimum Normal Cost, which explicitly identifies the expected expenses as a separate component of the minimum normal cost in accordance with 9904.412–50(b)(7)(ii)(B). See Table 4. For Segments 2 through 7, the normal cost is measured by the contractor's established immediate gain cost method, which implicitly recognizes expenses as a decrement to expected assumed interest rate, since the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 4: Net amortization installment based on the unfunded actuarial liability of $3,257,315 ($905,243 for Segment 1, and $2,352,072 for Segments 2 through 7) and the contractor's assumed interest rate in compliance with 9904.412–40(b)(2) and 9904.412–50(b)(4). See Table 6.

(c) *Assignment of Pension Cost.* In 9904.412–60.1(b), the Harmony Corporation measured the total pension cost to be $1,439,437 ($251,740 for Segment 1 and $1,187,697 for Segments 2 through 7). The contractor must now determine if any of the limitations of 9904.412–50(c)(2) apply at the segment level.

(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 8.

TABLE 8—CAS 412–50(c)(2)(i) ZERO DOLLAR FLOOR AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Measured Pension Cost ≥ $0	....	$251,740	$1,187,697	2
Assignable Cost Credit	....	....	....	3

Note 1: Because the provisions of CAS 412–50(c)(2)(i) are applied at the segment level, no values are shown for the Total Plan.

Note 2: See Table 7. The Assignable Pension Cost in accordance with 9904.412–50(c)(2)(i) is the greater of zero or the Harmonized Pension Cost.

Note 3: There is no Assignable Cost Credit since the Measured 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 met the harmonization criterion of 9904.412–50(b)(7)(i), the assignable cost limitation is based on the sum of the actuarial accrued liability and normal cost plus expense load, using the accrued benefit cost method in accordance with 9904.412–50(b)(7)(ii). Therefore, the actuarial accrued liability and normal cost plus expense load are measured by the minimum actuarial liability and minimum normal cost plus expense load. See Table 9.

TABLE 9—CAS 412–50(c)(2)(ii) ASSIGNABLE COST LIMITATION AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Actuarial Accrued Liability	....	$2,594,000	$14,225,000	2
Normal Cost	....	102,000	821,600	3
Expense Load on Normal Cost	....	8,840	....	4

TABLE 9—CAS 412–50(c)(2)(ii) ASSIGNABLE COST LIMITATION AS OF JANUARY 1, 2017—Continued

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Total Liability for Period		$2,704,840	$15,046,600	
CAS Actuarial Value of Plan Assets		(1,688,757)	(11,872,928)	5
(A) Assignable Cost Limitation Amount		$1,016,083	$3,173,672	6
(B) 412–50(c)(2)(i) Assigned Cost		$251,740	$1,187,697	7
(C) 412–50(c)(2)(ii) Assigned Cost	$1,439,437	$251,740	$1,187,697	8

Note 1: Because the assignable cost limitation is applied at the segment level when pension costs are separately calculated by segment or aggregation of segments, no values are shown for the Total Plan other than the Assigned Cost after consideration of the Assignable Cost Limit.

Note 2: For Segment 1, the actuarial accrued liability is measured by the accrued benefit cost method as required by 9904.412–50(b)(7), *i.e.,* the minimum actuarial liability as described in 9904.412–50(b)(7)(ii)(A). See Table 4. For Segments 2 through 7, the actuarial accrued liability is measured by the contractor's established immediate gain cost method since these the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 3: For Segment 1, the normal cost is measured by the accrued benefit cost method as required by 9904.412–50(b)(7), *i.e.,* the minimum normal cost as described in 9904.412–50(b)(7)(ii)(B). See Table 4. For Segments 2 through 7, the normal cost is measured by the contractor's established immediate gain cost method since these the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 4: For Segment 1, the normal cost is measured by the accrued benefit cost method as required by 9904.412–50(b)(7), *i.e.,* the minimum normal cost as described in 9904.412–50(b)(7)(ii)(B), which explicitly identifies the expected expenses as a separate component of the minimum normal cost. See Table 4. For Segments 2 through 7, the normal cost is measured by the contractor's established immediate gain cost method, which implicitly recognizes expenses as a decrement to the assumed interest rate since these the 9904.412–50(b)(7)(i) criterion was not met for these segments. See Table 3.

Note 5: See Table 2. The CAS Actuarial Value of Assets is used regardless of the basis for determining the liabilities. The CAS Actuarial Value of Assets allocated to Segment 1 and Segments 2 through 7 excludes the accumulated value of prepayment credits as required by 9904.412–50(a)(4).

Note 6: The Assignable Cost Limitation cannot be less than $0.

Note 7: See Illustration 9904.412–60.1(c)(1), Table 8.

Note 8: Lesser of lines (A) or (B).

(ii) As shown in Table 9, the contractor determines that the measured pension costs for Segment 1 and Segments 2 through 7 do not exceed the assignable cost limitation and are not limited.

(3) *Measurement of Tax-Deductible Limitation on Assignable Pension Cost:* (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 $15,674,697, which is the sum of the maximum tax-deductible contribution ($15,014,300), which is developed in the actuarial valuation prepared for ERISA, and the accumulated value of prepayment credits ($660,397) shown in Table 1. Since the tax-deductible contribution and accumulated value of prepayment credits 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 10.

TABLE 10—CAS 412–50(c)(2)(iii) TAX-DEDUCTIBLE LIMITATION AS OF JANUARY 1, 2017

	Total plan	Segment 1	Segments 2 through 7	Notes
Maximum Tax-deductible Amount	$15,014,300	$2,625,818	$12,388,482	1, 2
Accumulated Prepayment Credits	660,397	115,495	544,902	3, 4
(A) 412–50(c)(2)(iii) Limitation	$15,674,697	$2,741,313	$12,933,384	
(B) 412–50(c)(2)(ii) Assigned Cost	$1,439,437	$251,740	$1,187,697	5
Assigned Pension Cost	$1,439,437	$251,740	$1,187,697	6

Note 1: The Maximum Deductible Amount for the Total Plan is obtained from the valuation report prepared for ERISA purposes.

Note 2: The Maximum Tax-deductible Amount for the Total Plan is allocated to segments based on the assigned cost after application of 9904.412–50(c)(2)(ii) in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.

Note 3: The Accumulated Prepayment Credits for the Total Plan are allocated to segments based on the assigned cost after application of 9904.412–50(c)(2)(ii) in accordance with 9904.413–50(c)(1)(i) for purposes of this assignment limitation test.

Note 4: See Table 1.

Note 5: See Table 9.

Note 6: Lesser of lines (A) or (B).

(ii) For Segment 1, the assignable pension cost of $251,740, measured after considering the assignable cost limitation, does not exceed the 9904.412–50(c)(2)(iii) limit of $2,716,649. For Segments 2 through 7, the assignable pension cost of $1,187,697, measured after considering the assignable cost limitation, does not exceed the 9904.412–50(c)(2)(iii) limit of $12,958,048.

(d) *Actuarial Gain and Loss—Change in Liability Basis.* (1) Assume the same facts shown in 9904.412–60.1(b) for Segment 1 of the Harmony Corporation for 2017. Table 11 shows the actuarial liabilities and normal costs plus any expense loads for Segment 1 for 2016 through 2018.

TABLE 11—SUMMARY OF LIABILITIES FOR SEGMENT 1 AS OF JANUARY 1

	2016	2017	2018	Notes
"Going Concern" Liabilities for the Period:				
Actuarial Accrued Liability	$1,915,000	$2,100,000	$2,305,000	1
Normal Cost	89,600	89,100	99,500	1
Expense Load on Normal Cost				1, 2
Total Liability for Period	$2,004,600	$2,189,100	$2,404,500	
Minimum Liabilities for the Period:				
Minimum Actuarial Liability	$1,901,000	$2,594,000	$2,212,000	3
Minimum Normal Cost	83,800	102,000	96,500	3
Expense Load on Minimum Normal Cost	8,300	8,840	9,300	3, 4
Total Minimum Liability for Period	$1,993,100	$2,704,840	$2,317,800	
Interest Basis as Determined by Segment's Liabilities for Period	9904.412–50(b)(4)	9904.412–50(b)(7)(iii)	9904.412–50(b)(4)	5

Note 1: See Table 3 for 2017 values. For 2016 and 2018, the data for Segment 1 is taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation, including subtotals of the data by segment.

Note 2: Because the contractor's interest assumption, which satisfies the requirements of 9904.412–40(b)(2) and 9904.412–50(b)(4), implicitly recognizes expected administrative expenses there is no explicit amount shown for the normal cost.

Note 3: See Table 4 for 2017 values. For 2016 and 2018, the data for Segment 1 is taken directly from the actuarial valuation report prepared for ERISA purposes and supporting documentation, including subtotals of the data by segment. The values for 2016 are based on the transitional minimum actuarial liability and transitional minimum normal cost measured in accordance with 9904.412–64.1(a) and (b).

Note 4: For purposes of determining minimum normal cost, the contractor explicitly identifies the expected administrative expense as a separate component as required by 9904.412–50(b)(7)(ii)(B).

Note 5: For determining the pension cost for the period, the measurements are based on the actuarial accrued liability and normal cost unless the total minimum liability for the period exceeds the "Going Concern" total liability for the period. The measurement basis was separately determined for each segment in accordance with 9904.412–50(b)(7)(i).

(2) For 2016, the sum of the minimum actuarial liability and minimum normal cost does not exceed the sum of the actuarial accrued liability and normal cost. Therefore the criterion of 9904.412–50(b)(7)(i) is not met, and the actuarial accrued liability and normal cost are used to compute the pension cost for 2016. For 2017, the sum of the minimum actuarial liability and minimum normal cost exceeds the sum of the actuarial accrued liability and normal cost, and therefore the pension cost is computed using minimum actuarial liability and minimum normal cost as required by 9904.412–50(b)(7)(i). For 2018, the sum of the minimum actuarial liability and minimum normal cost does not exceed the sum of the actuarial accrued liability and normal cost, and the actuarial accrued liability and normal cost are used to compute the pension cost for 2018 because the criterion of 9904.412–50(b)(7)(i) is not met. Table 12 shows the measurement of the unfunded actuarial liability for 2016 through 2018.

TABLE 12—UNFUNDED ACTUARIAL LIABILITY FOR SEGMENT 1 AS OF JANUARY 1

	2016	2017	2018	Notes
Current Year Actuarial Liability Basis	9904.412–50(b)(4)	9904.412–50(b)(7)(iii)	9904.412–50(b)(4)	1
Actuarial Accrued Liability	$1,915,000	$2,594,000	$2,305,000	1
CAS Actuarial Value of Assets	(1,500,000)	(1,688,757)	(1,894,486)	2
Unfunded Actuarial Liability (Actual)	$415,000	$905,243	$410,514	

Note 1: See Table 11.

Note 2: The 2017 CAS Actuarial Value of Assets is developed in Table 2. For 2016 and 2018, the Actuarial Value of Assets for Segment 1 is taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation.

(3) Except for changes in the value of the assumed 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 2016 through 2018. The contractor's actuary measured the expected unfunded actuarial liability and determined the actuarial gain or loss for 2017 and 2018 as shown in Table 13.

TABLE 13—MEASUREMENT OF ACTUARIAL GAIN OR LOSS FOR SEGMENT 1 AS OF JANUARY 1

	2016	2017	2018	Notes
Actual Unfunded Actuarial Liability	(Note 1)	$905,243	$410,514	2
Expected Unfunded Actuarial Liability		(381,455)	(848,210)	3
Actuarial Loss (Gain)		$523,788	$(437,696)	

Note 1: The determination of the actuarial gain or loss that occurred during 2015 and measured on 2016 is outside the scope of this Illustration.

Note 2: See Table 12.

Note 3: Information taken directly from the actuarial valuation report prepared for CAS 412 and 413 purposes and supporting documentation. The expected unfunded actuarial liability is based on the prior unfunded actuarial liability updated based on the assumed interest rate in compliance with 9904.412–40(b)(2) and 9904.412–50(b)(4). Note that in accordance with 9904.412–50(b)(7)(iii)(D), the corporate bond yield rate is only used to determine the minimum actuarial liability but not to adjust the liability for the passage of time.

(4) According to the actuarial valuation report, the 2017 actuarial loss of $523,788 includes a $494,000 actuarial loss due to a change in measurement basis from using an actuarial accrued liability of $2,100,000 to using a minimum actuarial liability of $2,594,000, including the effect of any change in the interest rate basis. (See Table 11 for the actuarial accrued liability and the minimum actuarial liability.) The $494,000 loss ($2,594,000–$2,100,000) due to the change in the liability basis is amortized as part of the total actuarial loss of $523,788 over a ten-year period in accordance with 9904.412–50(a)(1)(v) and 9904.413–50(a)(2)(ii). Similarly, the next year's valuation report shows a 2018 actuarial gain of $437,696, which includes a $93,000 actuarial gain ($2,305,000–$2,212,000) due to a change from a minimum actuarial liability back to a an actuarial accrued liability basis, which includes the effect of any change in interest rate basis. The $93,000 gain due the change in the liability basis will be amortized as part of the total $437,696 actuarial gain over a ten-year period in accordance with 9904.412–50(a)(1) and 9904.413–50(a)(2)(ii).

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

9904.412–63 Effective Date.

(a) This Standard is effective as of February 27, 2012, hereafter known as the ''Effective Date'', and is applicable for cost accounting periods after June 30, 2012, hereafter known as the ''Implementation Date.''

(b) Following receipt of a contract or subcontract subject to this Standard on or after the Effective Date, contractors shall follow this Standard, as amended, beginning with its next cost accounting period beginning after the later of the Implementation Date or the receipt date of a contract or subcontract to which this Standard is applicable in accordance with paragraph (a) of this section. The first day of the cost accounting period that this Standard, as amended, is first applicable to a contractor or subcontractor is the ''Applicability Date of the CAS Pension Harmonization Rule'' for purposes of this Standard. Prior to the Applicability Date of the CAS Pension Harmonization Rule, contractors or subcontractors shall follow the Standard in 9904.412 in effect prior to the Effective Date.

(1) Following the award of a contract or subcontract subject to this Standard received on or after the Effective Date, contractors with contracts or subcontracts subject to this Standard that were received prior to the Effective Date shall continue to follow the Standard in 9904.412 in effect prior to the Effective Date. Beginning with the Applicability Date of the CAS Pension Harmonization Rule, such contractors shall follow this Standard, as amended, for all contracts or subcontracts subject to this Standard.

(2) Following the award of a contract or subcontract subject to this Standard received during the period beginning on or after the date published in the **Federal Register** and ending before the Effective Date, contractors shall follow the Standard in 9904.412 in effect prior to the Effective Date. If another contract or subcontract, subject to this Standard, is received on or after the Effective Date, the provisions of 9904.412–63(b)(1) shall apply.

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

9904.412–64.1 Transition Method for the CAS Pension Harmonization Rule.

Contractors or subcontractors that become subject to the Standard, as amended, during the Pension Harmonization Transition Period shall recognize the change in cost accounting method in accordance with paragraphs (a) and (b).

(a) The Pension Harmonization Rule Transition Period is the five cost accounting periods beginning with a contractor's first cost accounting period beginning after June 30, 2012, and is independent of the receipt date of a contract or subcontract subject to this Standard. The Pension Harmonization Rule Transition Period begins on the first day of a contractor's first cost accounting period that begins after June 30, 2012.

(b) Phase in of the Minimum Actuarial Liability and Minimum Normal Cost. During each successive accounting period of Pension Harmonization Rule Transition Period, the contractor shall recognize on a scheduled basis the amount by which the minimum actuarial liability differs from the actuarial accrued liability; and the amount by which the sum of the minimum normal cost plus any expense load differs from the sum of the normal cost plus any expense load.

(1) For purposes of determining the amount of the difference, the minimum actuarial liability and minimum normal cost shall be measured in accordance with 9904.412–50(b)(7)(ii).

(2) During each successive accounting period of the Pension Harmonization Rule Transition Period, the transitional minimum actuarial liability shall be set equal to the actuarial accrued liability adjusted by an amount equal to the difference between the minimum actuarial liability and actuarial accrued liability, multiplied by the scheduled applicable percentage for that period. The sum of the transitional minimum normal cost plus any expense load shall be set equal to the sum of normal cost plus any expense load, adjusted by an amount equal to the difference between the minimum normal cost and the normal cost, plus expense loads, multiplied by the scheduled applicable percentage for that period.

(3) The scheduled applicable percentages for each successive accounting period of the Pension Harmonization Rule Transition Period are as follows: 0% for the First Cost Accounting Period, 25% for the Second Cost Accounting Period, 50% for the Third Cost Accounting Period, 75% for the Fourth Cost Accounting Period, and 100% for the Fifth Cost Accounting Period.

(4) The transitional minimum actuarial liability and transitional minimum normal cost measured in accordance with this provision shall be used for purposes of the 9904.412–50(b)(7) minimum actuarial liability and minimum normal cost.

(5) The actuarial gain or loss attributable to experience since the prior valuation, measured as of the First Cost Accounting Period of the Pension Harmonization Rule Transition Period, shall be amortized over a ten-year period in accordance with 9904.413–50(a)(2)(ii).

(c) Transition Illustration. Assume the same facts for the Harmony Corporation in Illustration 9904.412–60.1(a) and (b), except that this is the Fourth Cost Accounting Period of the Pension Harmonization Rule Transition Period. As in Illustration 9904.412–60.1(a) and (b), the contractor separately computes pension costs for Segment 1, and computes pension costs for Segments 2 through 7 in the aggregate. The contractor has two actuarial valuations prepared: one measures the actuarial accrued liability and normal cost using the contractor's expected rate of return on investments assumption, in accordance with 9904.412–40(b)(2) and

9904.412–50(b)(4), and the other valuation measures the minimum actuarial liability and minimum normal cost based on the assumed current yields on investment quality corporate bonds in accordance with 9904.412–50(b)(7)(iii)(A). The actuarial valuations present the values subtotaled for each segment and in total for the plan as a whole.

(1) The contractor applies 9904.412–64.1(b) as follows:

(i) (A) For Segment 1, the $494,000 ($2,594,000—$2,100,000) difference between the minimum actuarial liability and the actuarial accrued liability is multiplied by 75%. Therefore for Segment 1, the minimum actuarial liability for purposes of 9904.412–50(b)(7) is adjusted to a transitional minimum actuarial liability of $2,470,500 ($2,100,000 + [75% × $494,000]).

(B) For Segments 2 through 7, the ($183,000) difference ($14,042,000 − $14,225,000) between the minimum actuarial liability and the actuarial accrued liability is multiplied by 75%. For Segment 2 through 7, the minimum actuarial liability for purposes of 9904.412–50(b)(7) is adjusted to a transitional minimum actuarial liability of $14,115,200 ($14,087,750 + [75% × ($183,000)]).

(C) The computation of the transitional minimum actuarial liability that incrementally recognizes the difference between the minimum actuarial liability and the actuarial accrued liability for Segment 1, and for Segments 2 through 7, is shown in Table 1 below:

TABLE 1—DEVELOPMENT OF TRANSITIONAL MINIMUM ACTUARIAL LIABILITY FOR FOURTH TRANSITION PERIOD

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Minimum Actuarial Liability		$2,594,000	$14,042,000	2
		(2,100,000)	(14,225,000)	3
Actuarial Accrued Liability Difference		$494,000	$(183,000)	4
Phase In Percentage (Period 4)		75%	75%	5
Phase In Liability Difference		$370,500	$(137,250)	6
Actuarial Accrued Liability		2,100,000	14,225,000	6
Transitional Minimum: Actuarial Liability		$2,470,500	$14,087,750	

Note 1: The values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.

Note 2: See Illustration 9904.412–60.1(b)(2)(ii), Table 4.

Note 3: See Illustration 9904.412–60.1(b)(2)(i), Table 3.

Note 4: The phase in percentage will be applied to positive or negative differences in the actuarial liabilities, since the purpose of the phase in is to incrementally move the measurement away from the actuarial accrued liability to the minimum actuarial liability, regardless of the direction of the movement.

Note 5: Appropriate transition percentage for the Fourth Cost Accounting Period of the Pension Harmonization Rule Transition Period as stipulated in 9904.412–64.1(b)(3).

Note 6: The actuarial accrued liability is adjusted by the phase in difference between liabilities, either positive or negative, in accordance with 9904.412–64.1(b)(2).

(ii) (A) For Segment 1, the $21,740 ($110,840–$89,100) difference between the minimum normal cost and the normal cost, plus expense loads, is multiplied by 75%. Therefore for Segment 1, the minimum normal cost plus expense load, for purposes of 9904.412–50(b)(7), is adjusted to a transitional minimum normal cost plus expense load of $105,405 ($89,100 + [75% × $21,740]).

(B) For Segments 2 through 7, the 92,260 ($913,860–$821,600) difference between the minimum normal cost and the normal cost, plus expense loads, is multiplied by 75%. Therefore, for Segments 2 through 7, the minimum normal cost for purposes of 9904.412–50(b)(7) is adjusted to a transitional minimum normal cost plus expense load of $890,795 ($821,600 + [75% × $92,260]).

(C) The computation of the transitional minimum normal cost plus expense load for Segment 1, and for Segments 2 through 7, is shown in Table 2 below:

TABLE 2—DEVELOPMENT OF TRANSITIONAL MINIMUM NORMAL COST FOR FOURTH TRANSITION PERIOD

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Minimum Normal Cost		$102,000	$840,700	2
Expense Load on Normal Cost		8,840	73,160	2, 3
Minimum Normal Cost Plus Expense Load		$110,840	$913,860	2
Normal Cost Plus Expense Load		(89,100)	(821,600)	4
Difference		$21,740	$92,260	5
Phase In Percentage (Period 4)		75%	75%	6
Phase In Normal Cost Difference		$16,305	$69,195	7
Normal Cost Plus Expense Load		89,100	821,600	7
Transitional Minimum:				

TABLE 2—DEVELOPMENT OF TRANSITIONAL MINIMUM NORMAL COST FOR FOURTH TRANSITION PERIOD—Continued

	Total plan	Segment 1	Segments 2 through 7	Notes
Normal Cost Plus Expense Load		$105,405	$890,795	

Note 1: The values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.
Note 2: See Illustration 9904.412–60.1(b)(2)(ii), Table 4.
Note 3: For minimum normal cost valuation purposes, the contractor explicitly identifies the expected administrative expenses as a separate component of minimum normal cost.
Note 4: See Illustration 9904.412–60.1(b)(2)(i), Table 3. Expected expenses are implicitly recognized as part of the contractor's expected rate of return on investments assumption.
Note 5: The phase in percentage will be applied to positive and negative differences in the normal costs plus expense loads, since the purpose of the phase in is to incrementally move the measurement from the normal cost plus expense load, to the minimum normal cost plus expense load, regardless of the direction of the movement.
Note 6: Appropriate transition percentage for the Fourth Cost Accounting Period of the Pension Harmonization Rule Transition Period stipulated in 9904.412–64.1(b)(3).
Note 7: The sum of the normal cost plus expense load is adjusted by the phase in difference between normal costs, either positive or negative, in accordance with 9904.412–64.1(b)(2).

(2) The contractor applies the provisions of with 9904.412–50(b)(7)(i) using the transitional minimum actuarial liability and transitional minimum normal cost plus expense load, in accordance with 9904.412–64.1(b)(4).

(i) The comparison of the sum of the actuarial accrued liability and normal cost plus expense load, and the sum of the transitional minimum actuarial liability and minimum normal cost plus expense load, for Segment 1, and for Segments 2 through 7, is summarized in Table 3 below:

TABLE 3—SUMMARY OF LIABILITY AND NORMAL COST VALUES FOR FOURTH TRANSITION PERIOD

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
"Going Concern" Liabilities for Period:				
Actuarial Accrued Liability		$2,100,000	$14,225,000	2
Normal Cost Plus Expense Load		89,100	821,600	3
Total Liability for Period		2,189,100	15,046,600	
Transitional Minimum Liabilities for the Period:				
Transitional Minimum Actuarial Liability		2,470,500	14,087,750	1
Transitional Minimum Normal Cost Plus Expense Load		105,405	890,795	3
Total Transitional Minimum Liability for Period		2,575,905	14,978,545	4

Note 1: The values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.
Note 2: See Table 1.
Note 3: See Table 2.
Note 4: If the threshold criterion is met, then the pension cost for the period is measured based on the Transitional Minimum Actuarial Liability and Transition Normal Cost Plus Expense Load.

(ii) For Segment 1, the Total Transitional Minimum Liability for the Period of $2,575,905 exceeds the total liability for the period of $2,189,100. (See Table 3.) Therefore, in accordance with 9904.412–50(b)(7)(i), the pension cost for Segment 1 is measured using the actuarial accrued liability and normal cost as measured by the transitional minimum actuarial liability and transitional minimum normal cost, which are based on the accrued benefit cost method. This measurement complies with the requirements of 9904.412–50(b)(7) and with the definition of actuarial accrued liability, 9904.412–30(a)(2), and normal cost, 9904.412–30(a)(18).

(iii) For Segments 2 through 7, the total liability for the period of $15,046,600 exceeds the Total Transitional Minimum Liability for the Period of $14,978,545. (See Table 3.) Therefore, in accordance with 9904.412–50(b)(7)(i), the pension cost for Segment 2 through 7 is measured using the actuarial accrued liability and normal cost, which are based on the projected benefit cost method.

(3) The contractor computes the pension cost for the period in accordance with the provisions of 9904.412–50(b)(7)(i), which considers the transitional minimum actuarial liability and transitional minimum normal cost plus expense load, in accordance with 9904.412–64.1(b).

(i) The contractor computes the unfunded actuarial liability as shown in Table 4 below:

TABLE 4—UNFUNDED ACTUARIAL LIABILITY FOR FOURTH TRANSITION PERIOD

	Total Plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Actuarial Accrued Liability		$2,470,500	$14,225,000	2

TABLE 4—UNFUNDED ACTUARIAL LIABILITY FOR FOURTH TRANSITION PERIOD—Continued

	Total Plan	Segment 1	Segments 2 through 7	Notes
CAS Actuarial Value of Assets	....	(1,688,757)	(11,872,928)	3
Unfunded Actuarial Liability	....	781,743	2,352,072	

Note 1: The values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.

Note 2: Because the Pension Harmonization criterion of 9904.412–50(b)(7)(i) has been met for Segment 1, the actuarial accrued liability is measured by the transitional minimum actuarial liability as required by 9904.412–64.1(b)(4). See Table 3. Because the Pension Harmonization criterion of 9904.412–50(b)(7)(i) was not satisfied for Segments 2 through 7, the actuarial accrued liability is based on the actuarial assumptions that reflect long-term trends in accordance with 9904.412–50(b)(4), *i.e.,* the transitional minimum actuarial liability does not apply.

Note 3: See Illustration 9904.412–60.1(b)(1)(ii), Table 2.

(ii) Measurement of the Pension Cost for the current period (Table 5):

TABLE 5—PENSION COST FOR FOURTH TRANSITION PERIOD

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Normal Cost Plus Expense Load	....	$105,405	$821,600	2
Amortization Installments	....	101,990	314,437	3, 4
Pension Cost Computed for the Period	1,343,432	207,395	1,136,037	

Note 1: Except for the Total Pension Cost Computed for the Period, the values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.

Note 2: See Table 3. Because the Pension Harmonization criterion of 9904.412–50(b)(7)(i) has been met for Segment 1, the sum of the normal cost plus the expense load is measured by the sum of the transitional minimum normal cost plus the expense load, as required by 9904.412–64.1(a). Because the Pension Harmonization criterion of 9904.412–50(b)(7)(i) was not satisfied for Segments 2 through 7, the sum of the normal cost plus any applicable expense load is based on the contractor's actuarial assumptions reflecting long-term trends in accordance with 9904.412–40(b)(2) and 9904.412–50(b)(4), *i.e.,* the transitional minimum normal cost plus the expense load does not apply.

Note 3: Net amortization installment based on the unfunded actuarial liability of $781,743 for Segment 1, and $2,352,072 for Segments 2 through 7, including an interest equivalent on the unamortized portion of such liability. See Table 4. The interest adjustment is based on the contractor's interest rate assumption in compliance with 9904.412–40(b)(2) and 9904.412–50(b)(4).

Note 4: See 9904.64–1(c)(4) for details concerning the recognition of the unfunded actuarial liability during the first Pension Harmonization Rule Transition Period.

(4) The Silvertone Corporation separately computes pension costs for Segment 1, and computes pension costs for Segments 2 through 7 in the aggregate.

(i) For the First Cost Accounting Period of the Pension Harmonization Rule Transition Period, the difference between the actuarial accrued liability and the minimum actuarial liability, and the difference between the normal cost and the minimum normal cost, are multiplied by 0%. Therefore the transitional minimum actuarial liability and transitional minimum normal are equal to the actuarial accrued liability and normal cost. The total transitional minimum liability for the period does not exceed the total liability for the period in conformity with the criterion of 9904.412–50(b)(7)(i). Therefore, the pension cost for the First Cost Accounting Period of the Pension Harmonization Rule Transition Period is computed using the actuarial accrued liability and normal cost.

(ii) The actuarial gain attributable to experience during the prior period that is measured for the cost accounting period is amortized over a ten-year period in accordance with 9904.412–50(a)(1)(v) and 9904.413–50(a)(2)(ii).

(iii) The contractor computes the pension cost for First Cost Accounting Period of the Pension Harmonization Rule Transition Period as shown in Table 6 below.

TABLE 6—COMPUTATION OF THE PENSION FOR THE FIRST TRANSITION PERIOD

	Total plan	Segment 1	Segments 2 through 7	Notes
	(Note 1)			
Amortization of Unfunded Liability Net Amortization Installment from Prior Periods	....	$81,019	$523,801	2
January 1, 2013, Actuarial Loss (Gain) Amortization Installment	....	(9,369)	(68,740)	3
Net Amortization Installment	....	71,650	455,061	....
Normal Cost plus expense load	....	78,400	715,000	4
Pension Cost Computed for the Period	....	150,050	1,170,061	

Note 1: The values for the Total Plan are not shown because the 9904.412–50(b)(7)(i) threshold criterion is applied separately for each segment.

Note 2: Amortization installments of actuarial gains and losses, and other portions of the unfunded actuarial liability identified prior to January 1, 2013, in accordance with 9904.412–50(a)(1)(v) and 9904.413–50(b)(2)(ii), including an interest adjustment based on the contractor's long-term interest assumption in compliance with 9904.412–40(b)(2) and 9904.412–50(b)(4).

Note 3: The actuarial gains for both Segment 1, and Segments 2 through 7, as measured as of January 1, 2013, are amortized over a ten-year period in accordance with 9904.413–50(a)(2)(ii) and 9904.412–64–1(b)(4). Note that although the source of the actuarial gains was the deviation between assumed and actual changes during the prior period, the gain is measured on January 1, 2013, and so the ten-year amortization period applies in the current period, including an interest adjustment based on the contractor's long-term interest assumption in compliance with 9904.412–40(b)(2) and 9904.412–50(b)(4).

Note 4: For the first period of the Pension Harmonization Rule transition period, the adjustment to the sum of the actuarial accrued liability and normal cost is adjusted by $0. Therefore the sum of the transitional minimum actuarial liability and transitional minimum normal cost plus expense load is equal to the sum of the actuarial accrued liability and normal cost plus expense load, and the criterion of 9904.412–50(b)(7)(i) was not met for either Segment 1, or Segments 2 through 7. The sum of the normal cost plus expense load is based on the sum of the going concern normal cost plus expense load.

■ 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 income and expenses in accordance with 9904.413–50(c)(7) 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.

(1) 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.

(2) 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 shall not exceed the sum of:

(i) The maximum tax-deductible amount computed for the plan as a whole, and

(ii) The accumulated value of prepayment credits not already allocated to segments apportioned among the segment(s).

■ 11. Section 9904.413–50 is amended by revising paragraphs (a)(2), (c)(1)(i) and (c)(7), (8), and (9) and adding paragraphs (b)(6) and (c)(12)(viii) to read as follows:

9904.413–50 Techniques for application.

(a) * * *

* * * * *

(2) Actuarial gains and losses shall be amortized as required by 9904.412–50(a)(1)(v).

(i) For periods beginning prior to the ''Applicability Date of the CAS Pension 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 fifteen-year period in equal annual installments, beginning with the date as of which the actuarial valuation is made.

(ii) For periods beginning on or after the ''Applicability Date of the CAS Pension Harmonization Rule,'' such actuarial gains and losses shall be amortized over a ten-year period in equal annual installments, beginning with the date as of which the actuarial valuation is made.

(iii) The installment for a cost accounting period shall consist of an element for amortization of the gain or loss, and 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) The assumed rate of interest, established in accordance with 9904.412–40(b)(2) and 9904.412–50(b)(4), shall be used to determine the present value of such receivable contributions as of the valuation date.

(ii) The market value of plan assets measured in accordance with paragraphs (b)(6)(i) 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 the 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 Internal Revenue Code at Title 26 of the U.S. C., as amended, and (B) the accumulated value of the prepayment credits not already allocated to segments, 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 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.

(8) If plan participants transfer among segments, contractors need not transfer assets or actuarial accrued liabilities, unless a transfer is sufficiently large to distort the segment's ratio of pension plan assets to actuarial accrued liabilities determined using the accrued benefit cost method. If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities transferred, determined using the accrued benefit cost method and long-term assumptions in accordance with 9904.412–40(b)(2) and 9904.412–50(b)(4).

(9) Contractors who separately calculate the pension cost of one or more segments may calculate such cost either for all pension plan participants assignable to the segment(s) or for only the active participants of the segment(s). If costs are calculated only for active participants, a separate segment shall be created for all of the inactive participants of the pension plan and the cost thereof shall be calculated. When a contractor makes such an election, assets shall be allocated to the segment for inactive participants in accordance with paragraphs (c)(5), (6), and (7) of this subsection. When an employee of a segment becomes inactive, assets shall be transferred from that segment to the segment established to accumulate the assets and actuarial liabilities for the inactive plan participants. The amount of assets transferred shall be equal to the actuarial accrued liabilities, determined under the accrued benefit cost method and long-term assumptions in accordance with 9904.412–40(b)(2) and 9904.412–50(b)(4), for these inactive plan participants. If inactive participants become active, assets and liabilities shall similarly be transferred to the segments to which the participants are assigned. Such transfers need be made only as of the last day of a cost accounting period. The total annual pension cost for a segment having active employees shall be the amount calculated for the segment and an allocated portion of the pension cost calculated for the inactive participants. Such an allocation shall be on the same basis as that set forth in paragraph (c)(1) of this subsection.

* * * * *

(12) * * *

(viii) If a benefit curtailment is caused by a cessation of benefit accruals mandated by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.,* as amended based on the plan's funding level, then no adjustment for the curtailment of benefit pursuant to this paragraph (c)(12) is required. Instead, the curtailment of benefits shall be recognized as follows:

(A) If the written plan document provides that benefit accruals are nonforfeitable once employment service has been rendered, and shall be retroactively restored if, and when, the benefit accrual limitation ceases, then the contractor may elect to recognize the expected benefit accruals in the actuarial accrued liability and normal cost during the period of cessation for the determination of pension cost in accordance with the provisions of 9904–412 and 413.

(B) Otherwise, the curtailment of benefits shall be recognized as an actuarial gain or loss for the period. The subsequent restoration of missed benefit accruals shall be recognized as an actuarial gain or loss in the period in which the restoration occurs.

■ 12. Section 9904.413–60 is amended by revising paragraphs (a) and (c)(12) and (18) 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 CAS Pension Harmonization Rule,'' the gain or loss shall be amortized over a fifteen-year period. For gains and losses measured for periods beginning on or after the ''Applicability Date for the CAS Pension Harmonization Rule,'' the gain or loss shall be amortized over a ten-year period.

(b) * * *

(3) Assume that besides the market value of assets of $10 million that Contractor B has on the valuation date of January 1, 2017, the contractor makes a contribution of $100,000 on July 1, 2017, 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, 2017, 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 on January 1, 2017, must also reflect $98,000 as the present value of the July 1, 2017, contribution of $100,000.

(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 of $22 million. In accordance with the sales agreement, Contractor M is required to transfer $20 million of plan assets to the new plan sponsored by the buyer. 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's new plan in accordance with the terms of the sales agreement. The adjustment amount, which is the difference between the remaining assets ($2 million) and the remaining actuarial liability ($0), is $2 million.

* * * * *

(18) Contractor Q terminates its qualified defined-benefit pension plan without establishing a replacement plan. At termination, the market value of assets is $85 million. All obligations for benefits are irrevocably transferred to an insurance company by the purchase of annuity contracts at a cost of $55 million, which thereby determines the actuarial liability in accordance with 9904.413–50(c)(12)(i). The contractor receives a reversion of $30 million ($85 million − $55 million). The adjustment is equal to the reversion amount, which is the excess of the market value of assets over the actuarial liability. However, the Internal Revenue Code imposes a 50% excise tax of $15 million (50% of $30 million) on the reversion amount. In accordance with 9904.413–50(c)(12)(vi), the $30 million adjustment amount is reduced by the $15 million excise tax. Pursuant to 9904.413–50(c)(12)(vi), a share of the $15 million net adjustment ($30 million − $15 million) shall be allocated,

without limitation, as a credit to CAS-covered contracts.

* * * * *

(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 pension cost measured pursuant to CAS 412 and this Standard for contract costing purposes may continue to recognize the benefit accruals, if the contractor has so elected. If there is evidence that the contractor might revoke the plan provision to restore the missed benefit accruals, then the contractor shall not make such election. Otherwise, the pension cost measured pursuant to CAS 412 and this Standard shall not recognize any benefit accruals until, and unless, the plan is subsequently amended to reinstate the accruals. Furthermore, when the plan is amended, the change in the actuarial accrued liability shall be measured as an actuarial gain or loss, and amortized in accordance with 9904.412–50(a)(1)(v) and 9904.413–50(a)(2)(ii).

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

9904.413–63 Effective Date.

(a) This Standard is effective as February 27, 2012, hereafter known as the ''Effective Date'', and is applicable for cost accounting periods after June 30, 2012, hereafter known as the ''Implementation Date.''

(b) Following receipt of a contract or subcontract subject to this Standard on or after the Effective Date, contractors shall follow this Standard, as amended, beginning with its next cost accounting period beginning after the later of the Implementation Date or the receipt date of a contract or subcontract to which this Standard is applicable in accordance with this paragraph (a). The first day of the cost accounting period that this Standard, as amended, is first applicable to a contractor or subcontractor is the ''Applicability Date of the CAS Pension Harmonization Rule'' for purposes of this Standard. Prior to the Applicability Date of the CAS Pension Harmonization Rule, contractors or subcontractors shall follow the Standard in 9904.413 in effect prior to the Effective Date.

(1) Following the award of a contract or subcontract subject to this Standard received on or after the Effective Date, contractors with contracts or subcontracts subject to this Standard that were received prior to the Effective Date shall continue to follow the Standard in 9904.413 in effect prior to the Effective Date. Beginning with the Applicability Date of the CAS Pension Harmonization Rule, such contractors shall follow this Standard, as amended, for all contracts or subcontracts subject to this Standard.

(2) Following the award of a contract or subcontract subject to this Standard received during the period beginning on or after the date published in the **Federal Register** and ending before the Effective Date, contractors shall follow the Standard in 9904.413 in effect prior to the Effective Date. If another contract or subcontract, subject to this Standard, is received on or after the Effective Date, the provisions of 9904.413–63(b)(1) shall apply.

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

9904.413–64.1 Transition Method for the CAS Pension Harmonization Rule.

The transition method for the CAS Pension Harmonization Rule under this Standard shall be in accordance with 9904.412.64.1 Transition Method for CAS Pension Harmonization Rule.

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