



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

MAR 27 2012

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

SUBJECT: Guidance on Cost Accounting Standards Board (CASB) Final Rule to Harmonize  
CAS 412 and 413 with the Pension Protection Act (PPA) of 2006

On December 22, 2006, the Director of Defense Procurement and Acquisition Policy (DPAP) issued a memorandum on the "Impact of the Pension Protection Act of 2006 on Forward Pricing" to guide contracting officers until the CASB issued a final rule harmonizing the CAS 412 and 413 with the PPA. This memorandum replaces the December 22, 2006 guidance.

The CASB issued a final rule in the Federal Register on December 27, 2011, regarding the measurement of costs for funded qualified defined benefit pension plans subject to ERISA Minimum Funding Requirements and covered by CAS 412 and 413. The final CAS rule also affects non-CAS covered contracts, i.e., those covered by FAR 31.205-6(j), since this FAR cost principle requires the use of CAS 412 and 413 to measure, assign and allocate allowable pension costs. The effective date for the new CAS rule was February 27, 2012.

Contracts awarded on or after February 27, 2012, should reflect projected costs and indirect rates consistent with the new CAS rule. Contracts awarded before that date should have been based on the prior CAS 412 and 413 rules for cost measurement.

Additional information of the changes in the rules and applicability to contracts is attached, along with guidance to contracting officers who have administrative cognizance for a contractor's indirect rates. The final CAS rules and this memorandum can be found on DPAP's Cost, Pricing, and Finance Directorate website at: <http://www.acq.osd.mil/dpap/cpf/index.html>.

My point of contact for this guidance memorandum is Mr. H. Clyde Wray. He can be reached at 571-372-6105 or [clyde.wray@osd.mil](mailto:clyde.wray@osd.mil).

Shay Assad  
Director, Defense Pricing

Attachment:  
As stated

cc:  
Director, DPAP

**Guidance on  
Cost Accounting Standard Board's (CASB)  
Final CAS 412 and 413 Rule on Pension Costs  
Published December 12, 2011**

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**Impact on Indirect Rates - *Effectivity* Date of New Rules**

The new CAS 412 and 413 rules on pension costs are effective for costs and indirect rates on contracts awarded on or after February 27, 2012. Contracts awarded:

- *Before* February 27, 2012, shall use costs and indirect rates consistent with the prior CAS rules, and the cost principle at FAR 31.205-6(j) on pension costs shall be construed to reference the old CAS 412 and 413.
- *On or after* February 27, 2012, the FAR 31.205-6(j) cost principle will be construed to reference the new CAS 412 and 413.

Contracting officers negotiating contract prices based on costs under FAR 15 should request that the contracting officer cognizant of indirect rates for the contractor provide advice on the need for new rates to be used for awards to be made on or after February 27, 2012. Decisions on the rates to be used and on any contract changes due to the new rules must be made consistently and only by the contracting officer who is assigned responsibility for the contractor's indirect rates and compliance with CAS 412 and 413. For contracts administered by the Defense Contract Management Agency (DCMA), this is normally the Divisional or Corporate Administrative Contracting Officer's (DACO/CACO) responsibility. The DCMA web link to identify the responsible CACO or DACO office, shown by the company name, is at:

[https://home.dema.mil/DCMAHQ/center\\_k/index.cfm](https://home.dema.mil/DCMAHQ/center_k/index.cfm)

**Phasing In of Impact - *Applicability* Dates for New Rules**

The final CAS 412 and 413 rules have applicability dates that differ from the effective date. Cost reimbursement calculation changes for *fully CAS-covered* cost type contracts and for all cost type contracts awarded *after* February 26, 2012 will generally follow the applicability schedules discussed below by contractor fiscal year. As mentioned above, however, a cost type contract awarded *before* February 27, 2012 that is *not* fully CAS-covered, will not have the calculation of the costs changed for the life of the contract (since the Cost and Payment Clause specifies the FAR/DFARS cost principles in effect *on the date of contract award* as the standard for allowability).

The new CAS rules are applicable (i.e., changes the cost calculations) for contractor Fiscal Years (FYs) beginning after June 30, 2012, or the beginning of the first contractor FY after award of a contract or subcontract over the threshold for cost or pricing data submission in FAR 15.403-4, whichever is later. Generally, for contractors who use the calendar year (CY) as their fiscal years (i.e., those with FYs running from January 1<sup>st</sup> to December 31<sup>st</sup>), the cost impact of the rule by CY is:

- CY 2012 pension costs will have no change in calculations,

- CY 2013 actual pension costs may have a change from the previous calculations due to a change from 15 years to 10 years in the amortization schedule for actuarial gains or losses incurred in CY 2012, and,
- CY 2014 and later years will have the most potential for cost changes given the phase-in of the larger pension liabilities.

Specifically, CY 2014 will recognize 25% of the difference in minimum cost compared to the regular CAS 412/413 costs of that year, CY 2015 will recognize 50%, CY 2016 will recognize 75%, and full recognition of each respective year's increased costs due to ERISA Minimum Funding requirements begins in CY 2017. However, the cost calculation change is only triggered in any given year if the contractor's minimum pension contribution calculated similarly to the calculation under the Employee Retirement Income Security Act (ERISA) (as adjusted during the phase-in period) is greater than the normal calculations under CAS 412/413 (see discussion below).

Contractors with non-calendar year FYs will vary on applicability dates for the cost calculation changes depending on the contractor's FY ending date. For example, a June 30<sup>th</sup> FY ending date would be the earliest impacted, moving the applicability dates six months sooner to July 1, 2012 instead of the January 1, 2013 date for CY contractors. Conversely, a May 31<sup>st</sup> FY ending date would be the last impacted, moving the applicability dates five months out to June 1, 2013.

### **Pension Cost Changes Due to the Harmonized CAS Pension Liability**

Determination of the harmonized pension costs will usually require review by the DCMA Contractor Insurance/Pension Review (CIPR) team and the DCAA auditor to validate the proper measurement, assignment, and allocation of pension costs. The contractor's pension costs will change under the new rules in any period that the sum of the minimum actuarial liability and the minimum normal cost (minimum annual pension contribution) exceeds the sum of actuarial accrued liability and the normal cost (measurement under prior CAS 412/413). When this occurs, the contractor shall measure and assign the pension cost for the period by using the minimum actuarial liability and minimum normal cost as the actuarial accrued liability and normal cost for all purposes; i.e., for both actual and projected pension costs. Note that in an indirect rate forecast, some years may be subject to the actuarial accrued liability and normal cost while other years may be subject to minimum actuarial liability and minimum normal cost.

### **Equitable Adjustments for CAS Covered Contracts**

Affected CAS covered contracts awarded before February 27, 2012 are eligible for equitable adjustment, to recognize the new CAS 412 and 413 required changes for contract costs incurred on or after the applicability date for the new rules. Additional guidance will be issued to discuss the equitable adjustment process.

Nonetheless, if a contracting officer who is cognizant of contractor costs for a defined benefit pension plans receives a request for equitable adjustment from a contractor, the request should identify *all* CAS covered contracts by contract type that were awarded *before* February 27, 2012 and are expected to continue performance after the change in calculation of annual costs becomes applicable to the contractor – January 1, 2014 for calendar year contractors (see

applicability date discussion above). These are the contracts that may require an equitable adjustment. Where there is a CACO/DACO/ACO network, the CACO will be responsible for settling the equitable adjustment. Where there is no CACO network, the cognizant Administrative Contracting Officer (ACO) is responsible for settling the equitable adjustment.

Any other changes to the contractor's disclosed practices regarding pension cost measurement made in preparation for the harmonization of pension costs to the provisions of the PPA are likely to be voluntary changes. The CAS 412 provisions regarding actuarial assumptions for the regular CAS 412 computation of pension costs were not changed. Any changes made in anticipation of PPA must still meet the requirements of CAS 412. The CIPR team and the DCAA auditor should be consulted concerning any increased costs resulting from a contractor's voluntary changes in the cost measurement to determine if the increased costs should be allowed on contracts awarded before February 27, 2012.

### **Special Contract Administration Issues**

ACOs who are cognizant over contractors that have non-CAS covered contracts awarded *prior* to February 27, 2012 with performance occurring beyond CY 2012, may need to take special measures to properly administer these contracts. In such situations, the ACO will likely need to have two sets of indirect rates for that contractor – one set using the new CAS 412/413 rule, the other using the prior 412/413 rule.

Specifically, for contract administration purposes, the contractor should have indirect rates that reflect the *new* calculation of pension costs for the phase-in period and thereafter. These will be used in new Forward Pricing Rate Agreements and Recommendations (FPRAs and FPRRs) as well as for billing and incurred cost rates for contracts issued after February 26, 2012 (and for any CAS covered contracts with an equitable adjustment to recognize the change in CAS 412/413).

In addition, the contractor should have (different) indirect rates for non-CAS-covered cost type contracts awarded *before* February 27, 2012 that are expected to continue performance after the change in calculation of annual costs becomes applicable to the contractor – January 1, 2013 for CY contractors. These are the contracts subject to the “old CAS 412/413” cost computation for life of the contracts, and not subject to any adjustment to recognize the new calculation methodology. Thus, these contracts will use different pension assumptions and have different indirect rates, then those contracts (described above) subject to CAS or issued after February 26, 2012.

### **Contractor Disclosure Statement Changes**

If the contractor has described the following actuarial assumptions in its CASB Disclosure Statement (DS-1) form, item 7.1.3.B., its disclosed practices shall be revised and submitted for:

1. The change in amortization period from 15 years to 10 years for actuarial gains and losses beginning with the contractor's Implementation Date pursuant to 9904.413-63 (for calendar year contractors that would be the 2013 measurement of the 2012 actuarial gain or loss). The amortization periods for gains or losses for years prior to 2012 would remain unchanged.

2. Disclosure of the basis used for determining the interest rate assumption for measuring pension cost pursuant to 9904.412.50(b)(7)(iii).

Normally, changes in the DS-1 are required to be submitted to the Government 60 days in advance. However, since the CASB final rule only provided 60 days between the publishing of the final rule and its effective date, we will extend the 60 days requirement for changes that were required because of the final rule to 180 days.

### **Subcontractor Costs and Equitable Adjustments**

Prime contractors should defer to rate and equitable adjustment determinations made by the contracting officer who is cognizant of the subcontractor's rates and pension costs if a contractor officer has been assigned. Any prime submission for equitable adjustment for subcontractor equitable adjustments should be submitted separately from any equitable adjustment proposal related to its own pension costs and be supported to the extent applicable by the determination made by the subcontractor's cognizant contracting officer.

### **Interest Rates Used to Determine CAS 412/413 Pension Costs**

The ERISA method of calculating pension costs uses shorter term interest rates and is more volatile than the regular CAS 412/413 calculation that remains based on long term assumptions, including long term assumptions concerning the earning rate for the pension assets. The main concern is that short term rates that are significantly higher or lower than the historical average for such rates should not be used to estimate pension costs without consideration of the return to historical trend data.

In calculating the ERISA-like alternative annual costs, the contractor should establish policies to identify the proper short term rate to use for the current year's calculations for estimation of both future costs and for incurred costs. For estimates of the cost for pensions for out-years in forward pricing rate proposals, the contractor should estimate that the short term rates will trend back toward the historical average for such rates (i.e., representing the prior 15 to 20 years (or more) of historical data).

We will issue guidelines in the coming months for safe harbor methods to use in estimates of future short term rates. However, until that guidance is issued, contractors should be expected to trend short term rates for the current year back to historical averages over a period of 4 to 6 years in calculating the pension costs for projected years' rates. We recommend that contractor proposals be discussed with, or evaluated, by the DCMA CIPR team.