

**# 02 Northrop-Grumman
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NORTHROP GRUMMAN

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November 3, 2008

Cost Accounting Standards Board
Attention: Raymond Wong
Office of Federal Procurement Policy
725 17th Street, NW, Room 9013
Washington, DC 20503
Via e-mail to casb2@omb.eop.gov

Reference: CAS Pension Harmonization ANPRM, CAS-2007-02S

Dear Mr. Wong:

Northrop Grumman Corporation appreciates this opportunity to comment on the CAS Board's Advance Notice of Proposed Rulemaking (ANPRM) issued in the Federal Register of September 2, 2008.

We commend the CAS Board for the quality of this ANPRM given the complexities and scope of the proposed rule. In our opinion, the CAS Board has made progress towards achieving harmonization of CAS with the Pension Protection Act (PPA). However, we believe the proposed rule must be improved in a number of aspects as significant issues remain.

In support of industry's efforts to improve the proposed rule, Northrop Grumman Corporation participated in drafting and vigorously supports the positions taken by the Aerospace Industries Association (AIA) and the National Defense Industries Association (NDIA) in their response dated November 3, 2008.

In addition, Northrop Grumman Corporation is submitting the following comments which address areas of particular interest to Northrop Grumman Corporation, or pertain to issues not addressed in the AIA / NDIA response.

Detailed Comments

1.) Effective Date of Final Rule

Northrop Grumman strongly supports the position expressed in the joint AIA / NDIA letter concerning the selection of an appropriate effective date for the final rule. Northrop Grumman believes that selection of an appropriate effective date for this regulation is necessary to maintain the intent of Congress when it drafted the eligible government contractor provisions of the PPA. The Board has a reasonable degree of latitude in selecting an effective date as CAS rules provide for an effective date up to 120 days after the final promulgation of a new or revised CAS. We urge the board to select an effective date early enough in a calendar year to provide for the near certain receipt of a CAS covered award by larger contractors after the effective date of the harmonized CAS and prior to year end (but due to the specific wording of Section 106 of the PPA it is critical that the CASB not specify an effective date of January 1, 2010). This simple action will avoid imposing ERISA funding requirements on eligible contractors during a year when CAS costs are measured and assigned using pre harmonization CAS 412 and 413.

2.) Interest Rate Used for Minimum Actuarial Liability Calculation

ANPRM CAS 412-40(b)(3)(ii) specifies in part:

“For purposes of measuring the minimum actuarial liability and minimum normal cost only, the interest assumption shall reflect the contractor’s best estimate of rates at which the pension benefits could effectively be settled based on the rates of return on high-quality fixed-income investments of similar duration to the pension benefits.”

The applicable interest rate for determining the minimum actuarial liability is also obliquely described in Item 1 of the Summary of Description of Draft Proposed Standard which states in part:

“The minimum actuarial liability definition is consistent with the definitions of the accumulated benefit obligation under Statement of Financial Accounting Standards No. 87 and the PPA funding target.”

Northrop Grumman is concerned that this reference could be construed as meaning that only the interest rates used in Financial Accounting Standards No. 87 or PPA funding targets are acceptable. Whether this is the intent of the rule is unclear. However, because of the extreme volatility which could result from changes in market interest rates, Northrop Grumman believes the CAS Board should explicitly take the position either in the standard or the preamble to the final publication, that contractors are permitted to calculate the minimum actuarial liability using a long-term expectation of high-quality bond yields, moving averages of reasonable durations beyond 24 months (a period described elsewhere in the proposed rule) or other techniques which enhance predictability.

3.) Transition Period – Five Year Phase In

Northrop Grumman believes that the rules providing for a five year phase in of certain harmonization provisions result in an undesirable and theoretically problematic shifting of costs from the years when the harmonized CAS 412 and 413 become effective to later years. This results in a bulge in costs in later years that will make programs unaffordable and contractors who continue to maintain defined benefit pension plans uncompetitive. This result is not theoretically sound and importantly has the effect of punishing contractors maintaining defined benefit pension plans which is contrary to the intent of the PPA. Accordingly, Northrop Grumman recommends that the CASB shorten the current five year transition period to three years.

4.) Transition Period – Mandatory Prepayment Credits

Northrop Grumman believes that the proposed transition rule for assigning existing mandatory prepayment credits to cost accounting periods is overly complex. The proposed transition rule divides existing mandatory prepayment credits into multiple increments which are then spread over varying periods of up to twelve years with a deferral of the commencement of the amortization of certain increments for up to four years. In addition to being overly complex and, unnecessarily protracted, the process described in the proposed rule results in an undesirable shifting of costs from earlier periods to the middle periods of the 12 year range. This deferral will create an unaffordable burden on program budgets due to the theoretically problematic bulge in costs in the middle years of the proposed 12 year period. NGC believes that the Board could remedy these issues by adopting a shorter overall amortization period of seven to ten years and through utilization of a simple straight line amortization technique.

5.) Definition of Mandatory Prepayment Credits

NGC strongly supports the positions taken in the AIA / NDIA letter in terms of the necessity and rationale for expanding the definition of mandatory prepayment credits. The definitional issue of which prepayment amounts should be classified as “mandatory” (as opposed to a voluntary) is

addressed at length in the AIA / NDIA letter. Appropriate categorization of amounts as mandatory prepayment credits is critical in order to maintain equitable assignment of costs. In addition, when comparing the minimum required funding amount under ERISA with the CAS assignable cost for purposes of determining mandatory prepayment credits, it would be helpful to clarify that the CAS assignable cost does not include any mandatory prepayment charges assigned to the period.

6.) Desirable Change Provisions for Plan Consolidations

Because of the increased funding requirements PPA imposes and the sweeping nature of changes to CAS 412 and 413 contemplated by the ANPRM, Northrop Grumman believes the CASB should consider adopting a provision addressing consolidation of plans with disparate practices by expressly providing for desirable change treatment for the impact of consequential changes in cost accounting practices. Such a provision could reasonably provide for tests to ensure the government's interests were not harmed by materially adverse reallocation of existing trust assets or pension liabilities. We believe this would result in lower administrative expense over time and should in certain circumstances partially mitigate contractors' cash flow issues. Suggested additional language might read as follows:

“Cost accounting practice changes required to implement pension plan realignments and plan consolidations are deemed to be desirable changes if the resulting combination does not materially reduce the government’s participation in pension plan assets net of pension plan liabilities.”

7.) Pension Segment Closings Resulting from Curtailments

This ANPRM in a new paragraph at 9904.413-50 (c)(12)(viii) reads in part:

“If a benefit curtailment is caused by a cessation of benefit accrual mandated by ERISA based on the plan’s funding level, and it is expected that such accruals will recommence in a later period, then no adjustment amount for the curtailment of benefit pursuant to this paragraph (c)(12) is required. Instead, the curtailment of benefits shall be recognized as an actuarial gain or loss for the period. Likewise the recommencement of benefit accruals shall be recognized as an actuarial gain or loss in the period in which benefits recommenced. If the written plan document provides that benefit accruals will be retroactively restored, then the intervening valuations shall continue to recognize the accruals in the actuarial accrued liability and normal cost during the period of cessation.”

Since the CASB is addressing an issue related to plan curtailments, we submit the following suggestion: Revise the proposed rule to also exempt curtailments resulting from voluntary decisions to freeze benefit accruals (in circumstances where the segment is not closed and performance on Government contracts continues) from pension segment closing adjustment requirements. In these instances, gains and losses continue in the plan from demographics, measurement of liabilities and from performance of assets in the trust relative to expectations. Although there are no ongoing normal costs, in order to eliminate risk to both the Government and the contractor, Northrop Grumman believes these gains and losses should be measured and allocated to final cost objectives in cost accounting periods subsequent to the curtailment.

Additional language to accomplish this objective might read as follows:

“If a benefit curtailment is caused by a voluntary cessation of benefit accrual no pension segment closing shall be deemed to have occurred provided the segment is neither closed nor sold, and contract performance or efforts to pursue new contracts subject to this standard are ongoing.”

Additional Opportunities for Public Comment

Northrop Grumman Corporation believes that a proposed rule of this magnitude is best addressed by an iterative process. In this instance we believe issuance of a Supplemental Notice of Advance Rule Making is necessitated by the magnitude of the substantive changes which we believe will

occur between the ANPRM and the contemplated final rule. Therefore, we encourage the CAS Board to consider issuing another ANPRM before proceeding to a NPRM.

In addition, modeling and other analysis of the ANPRM are ongoing. Northrop Grumman trusts that these additional inputs will be given due consideration in the promulgation process to the extent feasible even though the submissions occurred outside the prescribed window for formal comments on this ANPRM.

Conclusion

Thank you for the opportunity to support the Board in this important undertaking. We trust that the CAS Board will fully consider and address our comments. If you have any questions or need additional information, please contact Bill Mangan at 310-201-3486.

Sincerely,



Susan Cote
Vice President Corporate Contracts,
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