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Report on

The Follow-Up Inspection of Selected Aspects of the Department of Energy's Administation of Post Retirement Health Benefits

United States Government

Department of Energy

memorandum

DATE: May 5, 1994

REPLY TO
ATTN OF: IG-1

SUBJECT: INFORMATION: Report on "The Follow-up Inspection of Selected Aspects of the Department of Energy's Administration of Post Retirement Health Benefits"

TO: The Secretary

BACKGROUND

In 1987, the Department had a \$20 billion present value liability for its management and operating contractor employees' post retirement health benefits. The purpose of the inspection was to follow-up on post retirement health benefit related recommendations which were in our September 1990 report entitled "General Management Inspection of the San Francisco Operations Office." The primary objective of the inspection was to review the corrective actions which Departmental officials had taken in response to the recommendations regarding selected aspects of the management of post retirement health benefits generally and at the University of California. The report is being sent to inform you of our findings and recommendations.

DISCUSSION

We found that Departmental officials had taken actions which were responsive to the recommendations in the September 1990 report. However, we also found that Departmental officials had not been reviewing the detailed cost of employee benefits of companies being considered for management and operating contracts during the contract selection and negotiation process, even though contractor employee health benefit costs have been significant. For example, a total of \$28.3 million was paid for retired employees' health benefit insurance costs in Fiscal Years 1991 and 1992 for Lawrence Livermore National Laboratory and Lawrence Berkeley Laboratory.

Finally, we found that due to an Internal Revenue Service ruling, Departmental officials may be able to use some surplus pension funds with the Department's management and operating contractors to pay post retirement health benefit costs. According to Departmental officials, surplus pension funds totalled about \$1.7 billion for eight management and contracting contractors in 1992.

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We recommended that the Oakland Operations Office Manager establish procedures to periodically review post retirement health benefits to ensure that any changes in University of California health benefit policies and procedures are also reflected in costs charged to the Department. We also recommended that the detailed cost of employee benefits of companies being considered for management and operating contracts be considered by the Department during the contract negotiation process. We further recommended that the Deputy Assistant Secretary for Procurement and Assistance Management along with the Acting Chief Financial Officer quickly determine the feasibility of using surplus pension funds held by the University of California and other Department of Energy management and operating contractors to finance post retirement health benefits.

In commenting on our report, management agreed with the recommendations.

John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Under Secretary
Acting Associate Deputy Secretary for Field Management

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

REPORT ON
THE FOLLOW-UP INSPECTION OF
SELECTED ASPECTS OF THE
DEPARTMENT OF ENERGY'S ADMINISTRATION
OF POST RETIREMENT HEALTH BENEFITS

REPORT NO.: DOE/IG-0348
DATE ISSUED: May 5, 1994

OFFICE OF INSPECTIONS
WASHINGTON, D.C. 20585

Report on
the Follow-up Inspection of
Selected Aspects of the
Department of Energy's Administration
of Post Retirement Health Benefits

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Report on the
Follow-up Inspection of
Selected Aspects of the
Department of Energy's Administration
of Post Retirement Health Benefits

I. INTRODUCTION AND PURPOSE

Department of Energy Order 3890.1A, "Contractor Insurance and Other Health Benefits Programs" and the Department of Energy Acquisition Regulation Subpart 970.22, "Application of Labor Policies," require that Department of Energy Operations Office officials ensure that Management and Operating (M&O) contractors are spending public funds judiciously and reasonably for employee compensation, including benefits. According to a 1987 consultants' report, the present value of the Department's liability for its M&O contractor employees' post retirement health benefits was about \$20 billion. These benefits are a type of deferred compensation arrangement where an employer promises to exchange future health benefits for employees' current services.

In a September 1990 report entitled, "General Management Inspection of the San Francisco Operations Office," we made recommendations to Departmental officials regarding the administration of M&O contractor post retirement health benefits. The majority of these recommendations were directed to the administration of benefits paid by one M&O contractor, the University of California.

The primary purpose of this inspection was to determine what actions Departmental officials have taken in response to the recommendations made in our September 1990 report.

II. SCOPE AND METHODOLOGY

In conducting the inspection, we interviewed personnel at the University of California (University). These personnel were located in the Office of the President and at Lawrence Livermore National Laboratory (Livermore) and Lawrence Berkeley Laboratory (Berkeley). We also interviewed Department of Energy personnel at Headquarters' Offices of Procurement and Assistance Management, General Counsel, and Chief Financial Officer and at

the Oakland Operations Office (formerly the San Francisco Operations Office). Furthermore, we reviewed post retirement health benefit related regulations, and Department of Energy (Department) and contractor data and files at Livermore, Berkeley, the Department's offices in Washington, D.C., and Oakland. Finally, we reviewed prior Office of Inspector General reports covering post retirement health benefits.

This inspection was conducted in accordance with Quality Standards for Inspections issued by the President's Council on Integrity and Efficiency.

III. BACKGROUND

In 1987, Departmental officials procured a consulting firm's services to determine the Department's liability for post retirement health benefits. The consultant's report disclosed that the Department had a 1987 estimated post retirement health benefit liability with a present value of \$20 billion for its contractor employees -- \$345 million of this amount was for University of California employees at Livermore and Berkeley.

On June 20, 1989, the Office of Inspector General, Office of Audits issued a letter report entitled "Disclosure Report on Accounting for Post Retirement Health Benefits." This report addressed the Department's policy and practices for accounting for post retirement health benefits; and included a statement that the accounting profession may, in the future, require recognition of post retirement health benefits liability in financial statements.

In our September 1990 report entitled "General Management Inspection of the San Francisco Operations Office," we recommended that the Manager, Oakland Operations Office (1) determine and evaluate the reasonableness of the University of California's eligibility requirements for post retirement health benefits at Livermore and Berkeley; and (2) modify, when appropriate, the University contracts to ensure that the Department of Energy would have the necessary records to administer the benefits liability in the event of contract termination or change in contractor. We also recommended that the Department of Energy's Office of Controller (now the Office of Chief Financial Officer) consider whether there was a requirement for disclosure of the Department's liability for the University's and other M&O contractors' post retirement health

benefits in the Department's financial management system. At that time, the Manager, San Francisco Operations Office, and the Controller generally agreed with these recommendations.

Following up on the Department's actions that were taken in response to these recommendations was the primary purpose of this inspection. A summary of the results of the inspection is presented in the following section.

IV. SUMMARY RESULTS OF INSPECTION

As a result of the follow-up inspection we concluded that Departmental officials at the Oakland Operations Office and Headquarters had taken actions that were generally responsive to our post retirement health benefits related recommendations included in our September 1990 report. We also concluded that Departmental officials should confirm and periodically monitor the University of California's employee health benefits to ensure that the Department is paying for the same benefits that the University is paying for its other employees -- as required by the University's contract with the Department. We further concluded that the Department should consider detailed costs of employee health and other benefits proposed by companies during the M&O contract negotiation process.

Summarized below are the specific findings upon which our conclusions are based. We found that:

- o In our 1990 report, we determined that Oakland Operations Office officials were not aware of eligibility requirements which must be met in order to receive post retirement health benefits. Based on our recommendation, Oakland Operations Office officials reviewed the University's eligibility requirements and determined that these requirements were reasonable and consistent with their contract.
- o Consistent with the second recommendation in our 1990 report, Departmental officials had incorporated language in its contracts with the University to ensure that the Department would have access to records needed to administer post retirement health benefits in the event of contract termination or change in contractor.

- o Regarding the third recommendation in our 1990 report, the Acting Chief Financial Officer decided in May 1993 to disclose the Department's liability for contractor employees' post retirement health benefits in the Department's 1994 financial statements.

In addition to these findings regarding actions that Management took on the recommendations in our 1990 report, we found that:

- o The Department had not independently confirmed whether the University is providing its noncontract employees the same level of benefits that are provided to University employees at the Department's laboratories.
- o Although employee health benefit costs are significant -- \$28.3 million paid in FY 1991 and FY 1992 combined for Livermore and Berkeley -- the Department does not review the detailed cost of employee benefits of companies being considered for M&O contracts during the contract selection and negotiation process.
- o According to an Internal Revenue Service ruling, Departmental officials may be able to use some surplus pension funds to pay post retirement health benefit costs. According to Departmental officials, surplus pension funds totalled about \$1.7 billion for eight DOE contractors in 1992.
- o The Department would benefit from updating its policy and procedures to address new accounting requirements, issued in December 1990, for post retirement health benefits. We understand that Departmental officials are revising their procedures.

In response to this report, the Deputy Assistant Secretary for Procurement and Assistance Management and the Director, Office of Compliance and Audit Liaison, Office of the Chief Financial Officer generally agreed with the recommendations in the report. In an October 29, 1993 memorandum, the then-Acting Deputy Assistant Secretary for Procurement and Assistance Management stated that: "the issue of benefits costs is a major concern and a major challenge to the Department of Energy, and we seek the help of the IG in the development of a sound and solid program...."

More details on these findings and management's comments are presented in the following section of this report.

V. FINDINGS, RECOMMENDATIONS AND OBSERVATIONS

A. Eligibility Requirements and Costs Associated With Post Retirement Health Benefits

In our September 1990 report, we recommended that the Manager, Oakland Operations Office determine and evaluate the reasonableness of the University of California's eligibility requirements for post retirement health benefits. At the time, the Manager, Oakland Operations Office agreed with this recommendation and stated that he would confirm the eligibility requirements followed by the University.

In a September 11, 1992, memorandum, the Manager, Oakland Operations Office stated that:

"The eligibility requirements for post retirement health benefits for all University of California [University] employees, including employees at LBL [Berkeley] and LLNL [Livermore], are established by the UC [University] Office of the President...."

In this memorandum, Oakland Operations Office officials stated that they had compared the Office of Personnel Management's post retirement health benefits eligibility requirements for Federal employees and the eligibility requirements for the University's employees and concluded that:

"Because the OPM [Office of Personnel Management] provisions require only 5 years of service under a Federal health plan and the UC [University] provisions require 10 years of service under a UC [University] pension plan, it appears that the UC [University] post retirement health benefit eligibility requirements are reasonable in that they are no less restrictive (and, in fact, are more restrictive) than corresponding OPM requirements."

In response to our draft report, officials of the Headquarters Offices of Procurement and Assistance Management, Contractor Human Resource Management, and the Division of Contractor Financial Administration stated that it was inappropriate to

compare Federal Government standards to the University of California's standards. They stated that a more appropriate standard for comparison would be with other universities of similar size, stature, and geographic region.

Their response to our report also referred to a 1991 Buck Consultants report on "Postretirement Nonpension Benefit Design: A Delicate Balance." This report included the results of a questionnaire responded to by 246 organizations. According to the report, the questionnaire was designed to survey the post retirement health benefit policies and procedures followed by the organizations. Office of Contractor Human Resources Management officials advised us that the University's post retirement health benefit policies and procedures were generally consistent with policies and procedures of most of the respondents in the Buck Report. The officials also stated that, regardless of the comparison with the Buck Report results, it is DOE's policy to negotiate a personnel appendix or reach an agreement on policies and programs which are applicable to a contractor's private operations. They stated that these understandings have been reached with the University, and DOE is not paying any more for University employees at DOE laboratories than that being paid by the University for its other employees.

We asked the Office of Contractor Human Resources Management officials whether it had been confirmed that the Department was paying for the same benefits that the University of California was paying for its other employees. They stated that the Department assumes this without confirming whether it is actually occurring. We also asked Contractor Human Resources Management officials whether the Department considers the specific cost of salaries and benefits of companies as part of M&O contract negotiations. The Director, Office of Contractor Human Resources Management, stated that during the negotiation process detailed costs are not focused upon. He stated that, generally, the negotiation process focused on changes in policy and procedures and that costs were only given in terms of ranges or rates.

We found that the Department's acquisition regulation supports a negotiation approach that does not consider detailed costs. Department of Energy Acquisition Regulation 970.1508-1 states that cost or pricing data is not required of DOE M&O contractors during contract negotiations -- even though the Competition in Contracting Act of 1984 (CICA) generally requires cost or pricing data of other contractors of the Federal Government. CICA states that cost or pricing data is required during negotiations with

prime contractors of the Federal Government who must certify that the data is accurate, complete and current. CICA does provide for an exception to this requirement -- the agency head may determine that this requirement should be waived. CICA requires that this determination must be justified in writing.

In 1985, the Department's Procurement Executive, acting with delegated authority, made a "Findings and Determination Waiver of P.L. 98-369 Requirements for Cost or Pricing Data Under Management and Operating Contracts." The Procurement Executive stated that it was in the best interest of the Government to waive the requirements for M&O contractors to submit certified cost or pricing data. As a result, M&O contractors are exempt from submitting and certifying cost or pricing data prior to the award, extension or modification of their contract.

We believe that the detailed cost of benefit plans should be considered by the Department during contract negotiations because the cost of M&O contractors benefit plans are significant. For example, for Fiscal Year 1991 and Fiscal Year 1992, the Department paid a total of \$28.3 million for post retirement health benefits for University employees who retired from Livermore and Berkeley.

Conclusion

The University's contract currently states that health insurance programs will be in accordance with University policy. Because health insurance premiums costs incurred by the University for their employees that retire from Livermore and Berkeley laboratories are charged to the Department, we believe that the Department should confirm that the University is providing its non-DOE contract employees the same level of benefits that are provided to University employees at the Department's laboratories. Also, because of the size of the Department's estimated post retirement health benefit liability, Operations Office officials should be encouraged to periodically review and monitor their M&O contractors' post retirement health benefits' policy and procedures and costs to ensure they are reasonable, in line with other Universities and are consistent with Departmental policy and procedures. Furthermore, we believe the Department should reconsider requiring companies to submit cost or pricing data on employee benefits during negotiations of M&O contracts.

Recommendations

1. We recommend that the Acting Manager, Oakland Operations Office establish procedures to require periodic reviews of post retirement health benefits to ensure that any changes in University health benefit policies and procedures are also reflected in costs charged to the Department.
2. We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management require that the detailed cost of employee benefits of companies bidding for M&O contracts be considered by the Department during the contract negotiation process.

The Acting Manager, Oakland Operations Office concurred with recommendation 1 and stated that:

"The University of California (UC) offers a uniform benefits package to both management and operating (M&O) contractor employees as well as non-contractor University employees. That is, the benefits package is not dependent upon where in the system the employee works. Although we do not view this as a significant issue, it would be a simple task to ascertain such information and the Oakland Operations Office agrees to review post retirement health benefits to ensure they are provided on the same basis as other University employees."

The Deputy Assistant Secretary for Procurement and Assistance Management concurred in principle with recommendation 2 and stated that:

"Current policy provides for on-going assessments of personnel costs at the Department's Government-owned Contractor-operated (GOCO) facilities.

During the negotiation of either an award or extension of a contract for management and operation of an existing Department of Energy (DOE) facility, the Department has detailed cost data for existing benefit programs because the Department has already approved these programs for the existing work force. When consideration of a new management contractor is contemplated, the Request for Proposals (RFP) requires that compensation and benefits offered the work force be substantially comparable to the programs already in place. Thus, the existing compensation package for a DOE

GOCO facility cannot be disregarded in considering the benefits and other personnel programs of a bidding contractor. However, we will continue to evaluate whether there are more economical and effective compensation and benefit programs that should be considered for applicability to M&O contracts. Also, before any changes to existing benefit programs are approved by the contracting officer, the costs of such changes are always considered."

Inspector's Comment

The response of the Deputy Assistant Secretary for Procurement and Assistance Management reflects a long-standing practice of the Department. This practice is not to reduce contractor employee benefits when a new contractor is selected to manage and operate a DOE facility. Under the Contract Reform Initiative, we believe, this may be an issue that would be appropriate for re-consideration. In other words, if new contracting vehicles are established, pursuant to the Contract Reform Initiative, then it may be desirable not to strictly apply this policy to all new contracts.

B. Access To Records

In our 1990 report, we recommended that the Manager, Oakland Operations Office, modify, when appropriate, the University contracts to ensure that Department of Energy would have the necessary records to administer the post retirement health benefits liability in the event that their contracts were terminated or changed.

Although, the Manager, Oakland Operations Office, nonconcurred with this recommendation in 1990, the new contracts between Department of Energy and the University of California effective October 1, 1992, were modified consistent with our recommendation. The new contract states that:

"Upon termination of this contract the Government shall assume sole responsibility for all obligations, commitments, and claims that the University may have undertaken or incurred, the cost of which are allowable in accordance with the provisions of this contract; and the University shall execute and deliver all such papers and take all such steps as the Contracting Officer may require for the purpose of fully vesting in the Government any rights and benefits the University may have under or in connection with such obligations, commitments, or claims."

We believe this contract modification satisfied the intent of our recommendation.

C. Disclosure and Funding of Post Retirement Health Benefits

Historically, Departmental officials have funded post retirement health benefits on a "pay-as-you-go" basis in accordance with Department of Energy Order 3890.1A, "Contractor Insurance and Other Health Benefits Programs" (June 12, 1992). This Order states that funding in advance of benefits was prohibited unless required by State or Federal statutes. Thus, in the past, Departmental officials had only provided funds for post retirement health benefits costs on a fiscal year basis. For example, Departmental officials paid \$4.1 million for the University of California's retired employees at Berkeley in fiscal year 1992.

Disclosure

In our September 1990 report, we recommended that the Controller (now the Acting Chief Financial Officer) consider whether there was a requirement for disclosure of the Department's unfunded post retirement health benefit liability in the Department's financial management system. The Controller concurred with the recommendation, stating that the implications of the accounting professions' requirements on the Department's recognition and disclosure of unfunded liabilities for post retirement health benefits would be assessed. Historically, the Department had not disclosed to the public or to Congress its total post retirement health benefit liability -- an estimated present value of \$20 billion in 1987.

In December 1990, the Financial Accounting Standards Board issued a "Statement of Financial Accounting Standards No. 106: Employers' Accounting for Postretirement Benefits Other Than Pensions." This Statement established standards of financial accounting and reporting for an employer that offers post retirement benefits, other than pensions, to its employees. The Financial Accounting Standards Board defined post retirement benefit plan in Statement No. 106 as:

"....a deferred compensation arrangement whereby an employer promises to exchange future benefits for employees' current services."

The Statement provided that:

"Because the obligation to provide benefits arises as employees render the services necessary to earn the benefits pursuant to the terms of the **plan**, the Board believes that the cost of providing the benefits should be recognized over those employee service periods."

* * *

"This Statement relies on a basic premise of generally accepted accounting that accrual accounting principles provides more relevant and useful information than does cash basis accounting....Accrual accounting goes beyond cash transactions and attempts to recognize the financial effects of noncash transactions and events as they occur...."

* * *

"This Statement generally is effective for fiscal years beginning after December 15, 1992, except that the application of this Statement to plans outside the United States and certain small [no more than 500 plan participants], nonpublic employers is delayed to fiscal years beginning after December 15, 1994...."

The Statement provided two methods for recording previously unrecognized post retirement health benefits liability. One method provided that the total amount of the liability could be recognized immediately subject to certain limitations. Alternatively, the second method provided that the amount of the liability could be recognized on a delayed basis over the plan participants' future service periods, with disclosure of the unrecognized liability. With this method, Statement No. 106 provided that the liability be recognized over the average remaining service period of active participants; and if this period was less than 20 years, then 20 years could be used. Statement No. 106 also provided that delayed recognition could not result in less rapid recognition than accounting for the liability on a pay-as-you-go basis.

In a May 4, 1993, memorandum, the Acting Chief Financial Officer made the determination that the Department's liability for post retirement health benefits would be included as a footnote to its financial statements beginning with Fiscal Year 1994. According

to the Director, Office of Financial Policy, a copy of this determination was provided to the Office of Management and Budget.

Funding

In researching Statement No. 106, we noted that, according to an article entitled, "How Business is Dealing with FASB 106," which appeared in the Journal of Accountancy in March 1992, some companies were funding their future post retirement health benefit costs immediately. The article, for example, included a statement that Federal Government defense contractors were funding their post retirement health benefits and charging these costs to the Government. We believe the Department's contractors may also consider immediate funding of their post retirement health benefits and charge this cost to their Department of Energy contracts without Departmental officials' approval.

We discussed this matter with the Director, Office of Financial Policy and the Director, Contractor Human Resource Management. Both officials stated that, although post retirement health benefits are an allowable cost under M&O contracts, it was the Department's policy not to allow contractors to prefund these benefits. They also stated that although limited prefunding of post retirement health benefits liability has occurred in the past, the Department's M&O contracts do not authorize a contractor to unilaterally prefund their liability. The Director, Office of Financial Policy also stated that it would be difficult for an M&O contractor to unilaterally prefund post retirement health benefits without it being noticed by Departmental officials.

Conclusion

As part of the implementation of Financial Accounting Standards Board 106, Departmental officials should use their authority to ensure that contractors do not fund post retirement health benefits and charge these costs to the Department.

Recommendation

3. The Deputy Assistant Secretary for Procurement and Assistance Management with the Acting Chief Financial Officer should take action, within the Department's authority, to ensure that contractors do not fund post retirement health benefits without the prior approval of Departmental officials.

Both the Deputy Assistant Secretary for Procurement and Assistance Management and the Director, Office of Compliance and Audit Liaison, Office of the Chief Financial Officer concurred with this recommendation. In an October 29, 1993 memorandum, the then-Acting Deputy Assistant Secretary for Procurement and Assistance Management stated that "DOE policy does not permit prefunding of postretirement benefits for contractor employees. Isolated cases that have come to our attention have not been approved."

D. Surplus Pension Funds May Be Available to Pay Health Benefit Costs

Based on our limited review, it appears that a 1990 Internal Revenue Service ruling may allow the Department and its contractors to transfer some surplus pension funds to pay for post retirement health benefits. However, some conditions apply. For example, it appears that surplus pension funds can be used only to pay estimated retiree health benefits liability for the year of the transfer. Also, only pension funds which exceed at least 125 percent of the pension plan's current liability can be used. Furthermore, funds which were not used for current retiree health benefits must be transferred back into the pension fund. In this instance, a 20 percent excise tax is levied by the Internal Revenue Service.

In addition to these conditions, it appears that all plan participants must be vested in their accrued pension benefits and per capita retiree health expenses cannot be decreased for five years after a transfer. Finally, transfers can only be made once a year and only for tax years beginning before January 1, 1996.

Although the Department currently is centrally unaware of the total value of its pension assets the Department's Office of Contractor Management and Administration at Headquarters is developing a database to track the amount of pension fund assets with the Department's contractors. Officials from that Office provided information which showed that a combined estimated \$1.7 billion in surplus pension funds existed in 1992 for eight of the Department's contractors. Departmental officials stated that these contractors' pension funds represented 90 percent of the Department's pension assets. Under the Internal Revenue Services' ruling that only pension funds which exceed at least 125 percent of the pension plan's current liability can be transferred, the University of California had surplus pension funds available in the amount of \$71.7 million in FY 1992. These funds could cover close to 5 years of post retirement health benefit costs, based on the Fiscal Year 1992 post retirement health benefit costs of \$15.3 million for University of California employees at Livermore and Berkeley. Also, in Fiscal Year 1992, Sandia National Laboratory had surplus pension funds available in the amount of \$442.4 million.

Based on previous Office of Inspector General reports concerning the Department's administration of its M&O contractors' pension

plans, it appears that surplus pension funds have existed for some time and have not always been managed well by the Department. In June 1987, the Office of Inspector General's Office of Audits issued a report entitled, "Report on Management and Operating Contractors' Pension Plans." According to this report, in 1983 20 M&O contractors had 28 separate pension plans, with assets exceeding \$2.6 billion at that time. The report included a statement that the total pension plan contributions of \$222 million made during 1983 by 20 M&O contractors could have been reduced by \$94 million, or about 40 percent, had contributions been made at the minimum required funding level.

This report also included a statement that:

"The Department's rights to approximately \$600 million in excess pension assets....[were]....not fully protected. Eight pension plans....[had].... commingled plan assets with corporate activities and six of the Department's contracts with M&O contractors....[did]....not contain provisions covering disposition of plan assets upon contract termination...."

A 1992 Office of Inspector General, Office of Audits report entitled, "Pension Fund Activities at Department Laboratories Managed by the University of California," stated that Department officials were not aware of the amount of pension assets they were supposed to be protecting; and had not monitored actions by the University that had substantially reduced the stated value of the Department's financial interest in the pension funds. The report included a statement that even though the University of California Retirement Plan had surplus assets of over \$4 billion, Department officials did not have a supportable calculation of the Department's share of the surplus. The report further stated that the University used \$280 million of surplus pension funds to enhance University employee retirement benefits without the Department's officials approval or knowledge.

Finally, the report included a statement that Department officials had not effectively monitored the Department's contributions to the University pension funds to avoid unnecessary contributions. The report disclosed that the Department had contributed about \$230 million to the University of California Pension Plan after it was fully funded. The report also stated that the terms and conditions in the Department's

contracts with the University were such that Departmental officials had essentially no authority to preclude excessive pension contributions.

Conclusion

We believe that surplus pension funds should be administered to ensure that they are minimized and that they are being managed in the best interest of the Government and the American taxpayer. As part of this administration, the Department should consider whether surplus pension funds can be used to finance post retirement health benefits. It is especially important that this option be considered quickly since the apparent authority to use surplus pension funds may expire in January 1996.

Recommendation

4. We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management and the Acting Chief Financial Officer determine, in an expedited manner, the feasibility of using surplus pension funds held by University and other DOE M&O contractors to finance post retirement health benefits.

The Deputy Assistant Secretary for Procurement and Assistance Management concurred with this recommendation. The Director, Office of Compliance and Audit Liaison, Office of the Chief Financial Officer also concurred with this recommendation.

E. Prorating Post Retirement Health Benefit Costs

A February 4, 1991, memorandum from the Director, Management Evaluation and Industrial Relations Division, Oakland Operations Office, to the University of California's Assistant Vice President of Planning and Development questioned whether the University was prorating post retirement health benefits based on the length of an employee's service under contract with the Department. University officials responded that:

"The costs for post retirement health benefits for former LLNL [Livermore] or LBL [Berkeley] retired employees are not prorated based on the length of an employee's service. The lab [Livermore or Berkeley] is charged for the actual expense of the UC [University] contribution [to retirees health benefit premiums] and the respective charge is to the lab from which the employee retired."

During our inspection, we found that for the quarter ending March 31, 1992, the Manager, Oakland Operations Office stated in the Department's Audit Reports Tracking System Status Report that "financial liabilities for post retirement health benefits are based upon the location from which an [University] employee retires and are not prorated. Based on this information, the issue of post retirement health benefits will be discussed with UC [University] during the current contract renegotiations."

An official in the Office of the President, University of California, stated that:

"The University of California is interested in total University service and not in where in the system the person worked."

In an interview we conducted, an Oakland Operations Office, Industrial Relations Specialist, stated that:

"UC [University] does not track movements of personnel between their various offices. It does not keep records reflecting changes within their system. UC [University] does not split up the cost of PRHB [post retirement health benefits] between UC [University] and Department of Energy. UC [University] believes that the movements of personnel from the labs to UC [University] and vice versa 'washes out' or are about equal. This policy is not in writing."

Although Oakland Operations Office officials were aware of the University's position that the movement of personnel between the laboratories and the University were equal, no evidence was provided of a past or planned review to determine if this were true.

In order to get an indication of the potential impact of this practice of not prorating post retirement health benefits, we reviewed the personnel files of 202 out of 224 individuals who had retired from Berkeley between January 1, 1991, and December 14, 1992. Of the 224 individuals, Berkeley officials could not locate 22 retiree files due to the lack of procedures for recording when the retirees' files were taken from the file room and by whom. As a result, University officials could not determine who had the files or how long they had been missing.

Of the 202 retiree personnel files reviewed, 191 individuals worked entirely at Lawrence Berkeley Laboratory. Eleven retirees had worked both at Berkeley and at University of California activities not involving the Department of Energy.

The table below shows the number of years the 11 retirees worked at Berkeley and the University.

Comparison of Selected Employees'
Total Years Worked at
University of California versus Lawrence Berkeley Laboratory

<u>Employee</u>	<u>Total Years Worked</u>	<u>Years at the University</u>	<u>Years at Berkeley Laboratory</u>	<u>No. of Years Overlapping</u>	<u>Percent of time at the University</u>
1	33	2	31	2	6
2	31	14	17	--	45
3	28	6	22	--	21
4	31	20	11	--	65
5	15	2	13	--	13
6	23	16	7	--	70
7	31	2	29	2	6
8	27	15	12	--	56
9	37	12	25	--	33
10	37	12	25	--	32
11	40	12	27	--	30

NOTE: Except for "Total Years Worked", data for employees 9,10 and 11 are estimates.

Conclusion

Despite the statement previously cited that post retirement health benefits would be discussed during contract renegotiations, we noted that the new contract between the University and the Department, which was effective October 1, 1992, did not address the subject of prorating post retirement health benefits. According to the November 1992 Record of Negotiated Procurement, the assumption that transfers of employees between the University and any individual laboratory offset one another was eliminated from the pension provisions of

the contract. These provisions were revised to require an adjustment to the net annual accounting for pensions if more than 10 University employees changed employment to any individual laboratory. Even though we did not conduct an extensive review of the need for a similar requirement for health benefits, we believe that it is an important issue given the cost of post retirement health benefits and that Departmental officials should determine whether it would be in the interest of the Department to require prorating of post retirement health benefits costs. Otherwise, the Department will continue to reimburse the University for the full cost of the post retirement health benefits of retired employees even though some of them may work a percentage of their careers directly for the University activities not involving the Department of Energy. For example, for the 11 previously cited files we reviewed, the employees had spent an average of 37 percent of their total years employed involved in University activities not pertaining to the Department of Energy -- yet the Department had been paying 100% of their post retirement health benefit costs.

Recommendations

We recommend that the Acting Manager, Oakland Operations Office:

5. Establish procedures requiring periodic reviews of the movement of personnel between the University and the Department to ensure that only equitable health benefit costs for University employees retired from Departmental Laboratories are charged to the Department.
6. Ensure that the University develops procedures to control and safeguard retiree personnel files.

The Acting Manager, Oakland Operations Office concurred with recommendation 5, stating that the movement of personnel between the Department and the University will be tracked "by requesting periodic reports reflecting such activity as part of its pension oversight responsibilities." The Acting Manager also concurred with recommendation 6, stating that Berkeley currently has procedures for monitoring and safeguarding personnel files.

7. We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management determine whether it would be in the interest of the Department to require the prorating of post retirement health benefits costs.

The Deputy Assistant Secretary for Procurement and Assistance Management concurred with this recommendation and stated that "Based on the recent review of retiree files conducted by the Office of Inspector General, the Deputy Assistant Secretary for Procurement and Assistance Management has considered this recommendation and determined that the prorating of post-retirement health benefit costs would not be in the interest of the Department at this time...."

Inspector's Comment

We believe that the Deputy Assistant Secretary for Procurement and Assistance Management should base his determination on a more comprehensive review by Oakland Operations Office officials for the following reasons. First, the review conducted by the Office of the Inspector General was only performed to determine if there were instances where the Department was paying for the full cost of the retirement health benefits of retired University employees who had worked a number of years on University projects not associated with work at DOE Laboratories. Second, of the 224 personnel files we requested, 22 were not provided for our review because they could not be located at the time we conducted our field work. Finally, we did not review the files of retirees from the University of California Berkeley campus to determine how many may have had service at the Lawrence Berkeley Laboratory for which the University is paying the retiree benefit costs.

F. Oakland Operations Office Monitoring of Post Retirement Health Benefits

Department of Energy Order 3890.1A, "Contractor Insurance and Other Health Benefits Programs", dated June 12, 1992, and the Department of Energy Acquisition Regulation Subpart 970.22, "Application of Labor Policies," require that Department of Energy Operations Office officials ensure that M&O contractors are spending public funds judiciously and reasonably for employee compensation, including benefits.

Although we did not conduct an extensive review of this area, we believe that given the amount of funds being spent, it is important that Departmental officials periodically review post retirement health benefit costs submitted by the University. During Fiscal Years 1991 and 1992, Departmental officials reimbursed the University approximately \$28 million for post retirement health benefits at Livermore and Berkeley. According to the Director, Finance and Accounting Division, Oakland Operations Office, the expenditures from the University of California for post retirement health benefits are accepted without verifying their accuracy or validity. The Director also stated that the Oakland Operations Office only receives a letter stating the amount of funds spent on post retirement health benefits for a particular quarter. He further stated that University officials maintain the detailed records to support the amount charged for post retirement health benefits.

We requested copies of post retirement health benefit computer records from the Oakland Operations Office. According to personnel interviewed in the Office of Industrial Relations, no manual or computer records are maintained on post retirement health benefits at the Oakland Operations Office. Further discussion with these officials disclosed that the University was not required to provide this information to the Oakland Operations Office. These officials also stated that they had not conducted any reviews to ensure that the University was following the Department's regulations, policies, and procedures regarding post retirement health benefits or to ensure that costs for these benefits were reasonable and fairly allocated between the University and the Department. Department of Energy Order 3890.1A includes requirements for the Department's contractors and Heads of Field Elements to:

"....contain health care costs through innovation in insurance coverages....and consideration of alternative

delivery systems such as Health Maintenance Organizations...."

* * *

"....make judicious use of coinsurance, deductibles and copayments to make their employees conscientious consumers of health benefits. Contractors should also encourage outpatient care, second surgical opinions, wellness programs, and other methods."

The Heads of Field Elements, in this case Oakland Operations Office officials, were required to:

"Assure contractor compliance with the policies and procedures covered by this Order [Department of Energy Order 3890.1A]".

* * *

"Assure contractors maintain accounting systems and controls adequate for administering their insurance programs".

* * *

"Assure that, where appropriate, competitive procurement procedures are followed by contractors in obtaining needed insurance and other health benefits program coverage."

"Maintain liaison with the Office of Contractor Human Resource Management to provide assistance and review of contractors' insurance program and claims administration to determine their adequacy and cost effectiveness."

Along with the last requirement, this Order also requires that:

"....If there is reason to believe that more economical or satisfactory insurance arrangements can be obtained elsewhere, the contractor shall be requested [by Departmental officials] to seek proposals from other companies."

Finally, it is required that "competition will be used, where available, in providing health care to contractor employees." An

example of competition, according to this Order, would be making Health Maintenance Organizations a viable option.

In addition to the Oakland Operations Office officials not extensively reviewing cost information concerning post retirement health benefits for accuracy, University officials at Livermore and Berkeley were not reviewing cost information either. According to an official in the Office of Financial Management, Lawrence Livermore National Laboratory, the quarterly reports are reviewed to ensure that the location codes are correct. The same official stated that the quarterly reports are reviewed in order to ensure that any new names placed in the report had actually retired.

Conclusion

We believe that monitoring of post retirement health benefits is important because of the amount of the Department's liability for post retirement health benefits for employees at University-managed, Department-owned laboratories -- estimated at \$566 million in 1987, including \$221 million liability from Los Alamos National Laboratory. Other factors previously discussed include: 1) new requirements under the Financial Accounting Standards Board Statement No. 106 regarding these benefits; and 2) the ruling by the Internal Revenue Service allowing the use of surplus pension funds to pay for these benefits.

Effective monitoring of these benefits should help ensure that post retirement health benefits are being administered in the best interest of the Government.

Recommendations

We recommend that the Acting Manager, Oakland Operations Office:

8. Require the University to submit quarterly reports to support the cost of post retirement health benefits during that period.
9. Review, on a regular basis, information submitted by the University of California as well as conduct periodic reviews of the entire post retirement health benefits program.

In an October 29, 1993, memorandum, the then-Acting Deputy Assistant Secretary for Procurement and Assistance Management and the Acting Manager, Oakland Operations Office concurred with these recommendations, stating that "...[Oakland] should request quarterly submission of data by the UC as well as conduct periodic reviews of the entire postretirement health benefit program."

10. We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management issue a memorandum to Operations Office officials emphasizing the importance of routine review and monitoring of post retirement health benefits.

The Deputy Assistant Secretary for Procurement and Assistance Management concurred with this recommendation. In an October 29, 1993, memorandum the then-Acting Deputy Assistant Secretary for Procurement and Assistance Management stated that the "Operations Offices should be reminded of their responsibility for periodically reviewing and monitoring postretirement health benefit programs."

G. Updating of the Department's Contractor Health Benefits Policies and Procedures

Department of Energy Order 3890.1A, "Contractor Insurance and Other Health Benefits Programs" (June 12, 1992) covers contractor insurance and health benefits. This Order states that:

"Funding in advance for benefits earned by contractor retirees will not be allowed unless such funding is required by State or Federal statute. Such benefit payments will be provided for on a pay-as-you-go basis."

However, the Financial Accounting Standards Board Statement No. 106:

"... change[s] the prevalent current practice of accounting for post retirement benefits on a pay-as-you-go (cash) basis by requiring accrual, during the years that the employee renders the necessary service, of the expected cost of providing those benefits to an employee and the employee's beneficiaries and covered dependents."

With the establishment of Statement No. 106 and the IRS allowing the use of surplus pension funds to finance post retirement health benefits, we believe it is important that Department officials develop orders to address these changes. Even though Department of Energy Order 3890.1A addresses policy and procedures for contractor insurance and health benefits, it says very little about post retirement health benefits specifically. According to the Director, Division of Employee Compensation and Benefits, Department of Energy Order 3890.1A is being revised to address the requirements of the Financial Accounting Standards Board Statement No. 106. We believe that Departmental officials should expedite the revision of their procedures.

Recommendation

11. We recommend that the Director, Office of Contractor Human Resource Management, expeditiously follow through with plans to change Department of Energy Order 3890.1A to reflect the new requirements of Financial Accounting Standards Board Statement No. 106 regarding post retirement health benefits.

The Department's revisions to the Order should also consider the IRS ruling which allows the use of surplus pension funds to finance post retirement health benefits.

The Director, Office of Contractor Human Resource Management concurred in principle with this recommendation, stating that:

"Currently, it is the position of the Chief Financial Officer (CFO) and the Office of Management and Budget not to prefund post-retirement health benefits. The issue is still under review and consideration. Whenever the final policy is defined, it will be properly reflected in DOE guidance and CFO requirements. All available funding sources will be considered in the financing of post-retirement health benefits."

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