United States Government Accountability Office
Washington, DC 20548

June 19, 2008

The Honorable Byron L. Dorgan
Chairman
The Honorable Pete V. Domenici
Ranking Member
Subcommittee on Energy and Water Development
Committee on Appropriations
United States Senate

The Honorable Peter J. Visclosky
Chairman
The Honorable David L. Hobson
Ranking Member
Subcommittee on Energy and Water Development
Committee on Appropriations
House of Representatives

Subject: *Department of Energy: Information on Its Management of Costs and Liabilities for Contractors' Pension and Postretirement Benefit Plans*

For the past 60 years, the Department of Energy (DOE) and its predecessors have carried out their national security, environmental cleanup, and research and development missions through management and operating (M&O) contracts and other site contracts for operations at DOE-owned facilities. DOE currently has 43 such contracts with private companies and nonprofit organizations, including universities. Under the terms of these contracts, DOE reimburses contractors for the costs of providing pension and postretirement benefits—including health care, dental, and life insurance benefit plans—for current and former employees and their beneficiaries. DOE is ultimately responsible for reimbursing its contractors for allowable pension and postretirement benefit plan costs, and records a liability or asset in its financial statements for the funded status—plan obligations less plan assets—of these benefit plans. When these contracts are recompeted or expire, it is DOE's policy to ensure the continuation of these benefits—and the reimbursement of related costs—for incumbent contractor employees and eligible retirees by, for example, transferring benefit plan sponsorship responsibilities to a successor contractor or related company.

DOE's contractors sponsor pension plans for their employees, including both traditional pension plans, known as "defined benefit" plans, and 401(k) or similar plans, known as "defined contribution" plans. For defined benefit plans, DOE's private sector contractors must comply with the Employee Retirement Income Security Act of 1974 (ERISA), which establishes minimum funding standards for the amounts that private sector plan sponsors must set aside in advance to pay benefits when they are due.[1] For postretirement health care and other benefits, DOE's contractors typically do not set aside funds in advance because, unlike funding pension benefits, there are generally no requirements and few incentives to do so. As a result, DOE reimburses contractors on a pay-as-you-go basis for the amount needed to meet the employer's annual share of these costs, and these benefit obligations will represent an ongoing liability to DOE. In 2007, DOE's financial statements reported that contractors contributed $387 million and $334 million to defined benefit pension and postretirement plans, respectively. In 2007, DOE also reported a net liability of $69.5 million for defined benefit pensions and $10.3 billion for postretirement benefits. This net liability represents the present value of the estimated future benefit payments that will be made to contractor employees and retirees less the assets that have been set aside to cover these payments.

Since September 1996, DOE Order 350.1, *Contractor Human Resource Management Programs*, has set forth DOE's policy for oversight of contractors' pension and other benefit plans. In particular, Order 350.1 requires that DOE determine whether contractors' benefits costs are reasonable. To help make this determination, Order 350.1 requires that contractors benchmark the value or cost of their total benefit package by conducting either a benefit value or cost study that compares the value or costs of its total benefit package to those of at least 15 comparable organizations. DOE Order 350.1 states that if a contractor's total benefit value or cost study score exceeds 105 percent of its comparison group, DOE may require a corrective action plan to align the score to the

[1]DOE Order 350.1 states that reimbursable contractor costs for defined benefit pension plans shall not exceed the greater of (1) the plan's unfunded current liability as defined by ERISA or (2) the amount required to satisfy the ERISA minimum funding standard. Defined benefit pension plans sponsored by state and local governments, such as the University of California retirement plan, are exempt from most ERISA requirements. State and local laws generally govern these plans and typically require sponsors to set aside minimum amounts of funds for future pension payments when they are due.

comparison group; however, in the past DOE has not required several contractors to implement corrective action plans.

In April 2006, in response to its large and growing pension and postretirement liabilities for contractor employee benefits, DOE issued Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy*. Under Notice 351.1, DOE would have continued to reimburse contractors for the allowable benefit costs of existing “incumbent” employees and eligible retirees, but the Notice would have limited DOE’s reimbursement for new “nonincumbent” employees to the costs of “market-based” pension and health benefit plans. A pension plan was deemed “market-based” when, among other things, the plan was a defined contribution plan. However, in June 2006, DOE suspended this notice and subsequently decided not to reissue it in response to stakeholder and congressional concerns. Order 350.1 remains DOE’s controlling policy for reimbursing contractors’ pension and postretirement benefit costs.

The joint explanatory statement that accompanies the Consolidated Appropriations Act, 2008, directed us to assess the adequacy of DOE’s analysis of pension and medical liabilities.[2] In response, and in consultation with your staffs, we are providing information on (1) DOE’s analysis supporting its approval of the April 2006 policy changes contained in Notice 351.1, (2) DOE’s liabilities broken out by contractors’ defined benefit pension and postretirement plan components and among its M&O and other site contracts, and (3) DOE’s recent actions to manage its future costs and liabilities.

To provide information on DOE’s analysis supporting its approval of the policy changes in Notice 351.1, we reviewed information DOE provided to us in response to our request for any supporting documentation and decision documents related to the policy changes. We also interviewed DOE officials. To provide information on the distribution of DOE’s liabilities for contractor pension and postretirement plans, we reviewed plan data supporting the components of DOE’s liabilities reported in its fiscal year 2004-2007 financial statements, documentation of the work performed by independent auditors on DOE’s liabilities for those years, the trends in plan liabilities and costs, and information DOE provided to us in support of plan changes whose impact on plan obligations were reflected in fiscal years 2006 and 2007. We also interviewed DOE officials.

[2]Pub. L. No. 110-161, 121 Stat. 1844 (2007).

To provide information on DOE's actions to manage future liabilities, we reviewed relevant provisions in recently competed contracts, and we interviewed cognizant DOE officials. Based on information that DOE provided to us, we also compiled a list of contractors whose most recent benefit value study score exceeded 105 percent of the average of their comparison group. In addition, we reviewed our recent reports on DOE contractors' pension and postretirement benefits.[3]

In doing this work, we limited our review to DOE's policies for reimbursing allowable contractor benefit costs. We also did not audit or verify data provided by DOE or its contractors for individual benefit plan activity and balances, although we determined that these data were in the aggregate consistent with amounts and other information in DOE's financial statements and sufficiently reliable for our purposes. In addition, we did not audit or verify the amount or timing of payments by DOE to its contractors for allowable benefit costs or any other costs. Further, the limited number of plan changes we reviewed did not provide a basis for a conclusion on DOE's internal controls over benefit plan changes. Our review of DOE's actions to manage future costs and liabilities did not include identifying all actions DOE may have taken or evaluating the nature, extent, or effect of any such actions. Finally, we neither verified the accuracy of the results of the benefit value studies, nor did we evaluate contractors' conformance with DOE's requirements and guidance for performing such studies. We conducted our work from October 2007 through June 2008 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We briefed your staffs on the results of this work on March 3, 2008, and March 13, 2008. This report transmits the briefing slides, which consist of high-level talking points and were not designed to represent an exhaustive review of the issues discussed. (See encl. I.) In a separately issued report, we are providing you with detailed information regarding the funded status of individual contractor pension and other postretirement benefits

[3]GAO, *Department of Energy: Certain Postretirement Benefits for Contractor Employees Are Unfunded and Program Oversight Could be Improved*, GAO-04-539 (Washington, D.C.: Apr. 15, 2004) and *Department of Energy: Additional Opportunities Exist for Reducing Laboratory Contractors' Support Costs*, GAO-05-897 (Washington, D.C.: Sept. 9, 2005).

calculated using DOE-prescribed actuarial assumptions and the results of individual contractor benefit value studies performed in accordance with DOE policy and procedure guidance. Because DOE believes that the funded status and benefit value scores of contractor benefit plans may be proprietary, we removed information from this report that could associate a funded status amount or benefit value score with a particular facility or contractor.

Results in Brief

DOE officials told us that the decisions underlying the policy changes in its April 2006 Notice 351.1 were informed over a period of years by the trends in cost reimbursements, budgetary uncertainties, and by consulting actuaries and others, including DOE Inspector General reports and our reports. The documentation DOE provided us demonstrates that it recognized the historical and possible future trend of its liabilities and costs related to contractor benefit plans. However, DOE officials acknowledged that there was no formal compiled record or summary analysis of the documentation and factors considered before Notice 351.1 was issued. We found that the documentation provided to us contained only limited evidence that DOE had considered policy alternatives, the sensitivities of stakeholders to the policy choices reflected in Notice 351.1, or the near- and long-term financial and mission impacts of the changes made. Further, the decision document reflecting the Deputy Secretary's approval of Notice 351.1 did not include the basis on which approval was recommended. However, DOE officials told us that issuance of the Notice adequately demonstrated evidence of internal consideration and senior level-approval of Notice 351.1.

As of September 30, 2007, benefit obligations for DOE contractors' defined benefit pension and postretirement plans were approximately $27.5 billion and $10.5 billion, respectively. With assets of $27.4 billion and $161.6 million, the resulting net funded status (net liability) was $69.5 million and $10.3 billion for the pension and postretirement benefit plans, respectively. The funded status of DOE contractor benefit plans can change from one year to the next as benefits accrue and are paid, and due to other factors. The contractors' methods for funding these benefit costs—generally either by setting aside funds while employees are working (pension) or on a pay-as-you-go basis after employees have retired (postretirement benefits other than pensions)—directly impact the funded status of the plan. Other factors that can cause the funded status of defined benefit plans to fluctuate from one year to the next include changes in plan experience, such as returns on plan assets that are different from what was assumed, and changes to the benefits that employees receive or the portion of benefit costs borne by the employer. For example, the net funded status of contractor pension plans changed from an underfunding of $4.5 billion in fiscal year 2006 to an underfunding of $69.5 million in fiscal year 2007 due in large measure to a significant increase in the returns on plan investments. Because postretirement benefits are not generally funded in advance of being paid, these benefit obligations will represent an ongoing liability to DOE. From fiscal years 1997 to 2007, the net funded status of contractor postretirement benefits generally declined from an underfunding of $5.0 billion to an underfunding of $10.3 billion.

Since 2005, DOE has awarded 14 contracts that contain new provisions designed to limit pension and postretirement benefits for new employees to no more than 105 percent of comparable organizations. While this focus on the benefits of new employees is similar to Notice 351.1, DOE's current policy and practices do not require that contractors offer defined contribution pension plans to new employees in order for contractors to be reimbursed for benefit costs. Rather, DOE requires that new employees receive a total benefits package that does not exceed the 105 percent benchmark. In so doing, DOE continues to follow the Order 350.1 provision that could limit reimbursement if a contractor's total benefit value or cost study score for all benefits exceeds the 105 percent benchmark of the comparison group, but is applying this provision primarily to new employees. For contractors with benefit scores in excess of this benchmark, the contractor may choose to establish a second tier of benefits for new employees or make changes to their benefit plans to align with the market. For recently awarded contracts, contractors at DOE's National Nuclear Security Administration and Office of Environmental Management facilities have generally established separate benefit plans for new employees, which usually do not include a defined benefit pension plan. Recent contracts awarded by DOE's Office of Science have generally retained a single set of benefit plans for all contractor employees because the benefit value scores for these plans were near the 105 percent benchmark. DOE expects that implementing Order 350.1 in this way will not substantially affect the department's pension and postretirement benefits costs and liabilities for the next 20 to 30 years because the requirements are directed at new employees typically hired at the beginning of their careers. Incumbent employees—those hired before a contract's award and eligible retirees—will continue to receive their existing benefits or a substantial equivalent.

Agency Comments and Our Evaluation

We provided DOE with a draft of this report for its review and comment. In written comments, DOE stated that the draft report correctly reflects the status of departmental policy regarding reimbursement of contractor employee benefits for its 43 management and operating and other site contracts. However, DOE disagreed with the implication that the issuance of Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy*, was not based on considered analysis. Specifically, DOE stated that while the department had not compiled a "formal record" of its work leading up to the issuance of that Notice, it had provided us with considerable documentation of its concerns about the growing liability of DOE for contractor employee benefit costs. DOE noted that upward trends in its reimbursement of contactor employee benefits and the department's heightened concern were evidenced by annual actuarial reports prepared by DOE's contractors, various communications within DOE, two letters provided to the Congress, and other documents that DOE had provided to us. DOE believes that in the aggregate, these documents show that a great deal of considered work and analysis formed the basis for issuance of Notice 351.1. We disagree. We believe that the materials that DOE provided did not include a comprehensive assessment of existing DOE policies, an analysis of the potential impacts of alternative strategies for managing contractor benefit plan liabilities, or an indication of the information that DOE management relied on in developing the Notice 351.1 policy changes. These materials contained only limited evidence that DOE had considered policy alternatives, the sensitivities of stakeholders to the policy choices reflected in Notice 351.1, or the near- and long-term financial and mission impacts of the changes made despite the importance of these changes to DOE's policy on contractor employee pension and medical benefits. For example, not even the decision document reflecting the Deputy Secretary's approval of Notice 351.1 included the basis on which approval was recommended. The bottom line is that the connection between what DOE cites as evidence of its concerns and its policy changes as reflected in Notice 351.1 is not readily apparent from the documents DOE provided us. (See encl. X for DOE's comments and our response.) DOE also provided technical comments, which we have incorporated as appropriate.

We are sending copies of this report to the Secretary of Energy and interested congressional committees. We will also provide copies to others on request. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions on the matters discussed in this report, please contact Mark Gaffigan at (202) 512-3841 or gaffiganm@gao.gov or Jeanette Franzel at (202) 512-9471 or franzelj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report were Richard Cheston and Robert Owens (Assistant Directors), Scott Heacock, Scott McNulty, H. Donald Campbell, Frederick Evans, Aaron Johnson, Alison O'Neill, and Barbara Timmerman.

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Enclosures (10)

Enclosure I: Briefing Slides

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Department of Energy: Information on Its Management of Costs and Liabilities for Contractors’ Pension and Postretirement Benefit Plans

Subcommittee on Energy and Water Development
Committee on Appropriations
United States Senate and House of Representatives

U.S. Government Accountability Office
March 2008

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- For the past 60 years, the Department of Energy (DOE) and its predecessors have carried out their missions through management and operating (M&O) and other site contracts for operations at DOE-owned facilities. DOE currently has 43 contracts for these facilities that cost over $16 billion annually.
- DOE contractors generally provide their employees with pension plans, health care benefit plans, and other postretirement benefits. DOE contractors typically offer their employees a traditional pension plan, known as a “defined benefit” plan, and some contractors offer a “defined contribution” pension plan, such as a 401(k) plan. Contractors also offer their employees postretirement benefits other than pensions, including health care, dental, and life insurance benefits.
- DOE reimburses these contractors for the costs of providing pension and postretirement benefits to current and former employees and their beneficiaries. DOE is ultimately responsible for reimbursing its contractors for the allowable costs of these plans. DOE records a liability or asset in its financial statements for the funded status—plan obligations less plan assets—of contractor benefit plans.

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Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- DOE's policy on the establishment, funding, administration, and oversight of welfare and pension benefit plans by its contractors is set forth in Order 350.1, *Contractor Human Resource Management Programs*, first issued in September 1996. Order 350.1 requires that contractor benefit plans meet guidelines set forth in the Federal Acquisition Regulation and the cost principles of DOE's own acquisition regulation in order for benefit costs under cost reimbursement contracts to be deemed reasonable and allowable and therefore reimbursable.
- Order 350.1 also requires that contractors perform periodic studies comparing the value or costs of their employee benefit plans to those of a group of comparable organizations and that the relative value or cost of their plans be below certain limits.

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- Under Order 350.1, DOE determines whether contractors' benefits costs are reasonable and allowable and therefore reimbursable by having contractors benchmark their total benefit package by using one of the following:
  - Benefit Value Study: compares the value of total benefits offered by the contractor, such as qualified pension plans and health benefits, with the value of total benefits of at least 15 comparable organizations—at most 20 percent of these organizations can be DOE contractors. A national actuarial consulting firm makes this comparison every 3 years.
  - U.S. Chamber of Commerce Employee Benefit Survey Comparison (cost study): an annual analysis of the cost of benefits on a per capita basis compared with the costs reported in the annual U.S. Chamber of Commerce Employee Benefits Study.

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- Order 350.1 states that if the value or cost of a contractor's total benefit package exceeds 105 percent of the average of the comparison group, the DOE contracting officer may require a Corrective Action Plan that identifies changes that would bring the benefits into conformance with the comparison group.
- Some DOE contracts currently exceed the 105 percent threshold but do not have Corrective Action Plans in place. (See encl. II.)
- The allowability of costs incurred by educational institutions, including benefit costs, are governed by the cost principles in OMB Circular A-21, *Cost Principles for Educational Institutions* rather than DOE Order 350.1. Some universities are the M&O contractors of DOE laboratories. For example, the University of California operates Lawrence Berkeley National Laboratory, and Stanford University operates the Stanford Linear Accelerator Center.

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- DOE Order 350.1 states that reimbursable contributions for defined benefit pension plans shall not exceed the greater of (1) the plan's unfunded current liability as defined by the Employee Retirement Income Security Act of 1974 (ERISA) or (2) the amount required to satisfy the ERISA minimum funding standard.
- ERISA establishes minimum funding standards for the amounts that plan sponsors must set aside in order to fund defined benefit pension obligations. These prefunding requirements apply to private sector DOE contractors that offer defined benefit pensions.
- Defined benefit pension plans sponsored by state and local governments, such as the University of California retirement plan, are exempt from most ERISA requirements. However, these pension plans are generally governed by state and local laws that also typically provide for setting aside funds to pay for future pension benefits when they are due.

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- Unlike defined benefit pension plans, there are no federal law requirements and few incentives for private sector employers to prefund other postretirement benefits, including postretirement health care benefit plans. Similarly, there are generally no requirements for state and local governments to prefund government-sponsored postretirement benefit plans.
- Typically, plan sponsors do not prefund postretirement health benefits. DOE contractors generally pay for postretirement health and other benefit plans on a pay-as-you-go basis (PAYGO). In turn, DOE reimburses contractors under PAYGO for the amount needed to meet the employer's annual share of these costs.

Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs

- DOE's policy in Order 350.1 for both contractor pension and postretirement benefit plans is to continue to reimburse the costs of benefits earned by existing plan participants subsequent to contract termination or expiration, according to the approved benefit plans and on a funding basis most reasonable to DOE.
- Consistent with Order 350.1, DOE's M&O and other site contracts also generally provide that in the event of contract termination or expiration DOE will provide for benefit continuation and reimbursement of related costs through the existing contractor or a replacement contractor.
- For financial accounting purposes, DOE records an expense for the amount of cost reimbursements to contractors, including benefit plan costs. DOE also records a liability or asset in its financial statements for the funded status (plan obligations less plan assets) of contractor pension and postretirement plans in accordance with *Statement of Financial Accounting Standards (SFAS) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*[1]

[1] DOE implemented SFAS No. 158 in fiscal year 2007. This standard amends SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Prior to this standard the liability or asset an entity was required to report on its financial statements did not include certain deferred costs or credits, obligations or assets, and losses or gains.

Background: Trends in the Funded Status of DOE Contractors' Defined Benefit Pension and Postretirement Benefits, Fiscal Years 1997-2007

- From fiscal years 2001 through 2005, the funded status of contractors' defined benefit plans declined rapidly. Further, as shown in figures 1 and 2 on the following pages:[2]
  - The funded status of defined benefit pensions can fluctuate significantly from one year to the next. For example, the net funded status of contractor pension plans changed from an underfunding of $4.5 billion in fiscal year 2006 to an underfunding of $69.5 million in fiscal year 2007. This change was primarily due to a significant increase in the returns on plan investments and an increase in the discount rate used to estimate the current value of expected benefit payments.
  - From fiscal years 1997 to 2007, the net funded status of contractor postretirement benefits generally declined from an underfunding of $5.0 billion to $10.3 billion. These benefit obligations will represent an ongoing liability to DOE because, unlike defined benefit pensions, these benefits generally are not funded in advance of being paid.

[2] The amounts for each fiscal year in figures 1 and 2 reflect the net funded status of DOE contractors' benefit plans as required by SFAS No. 158.

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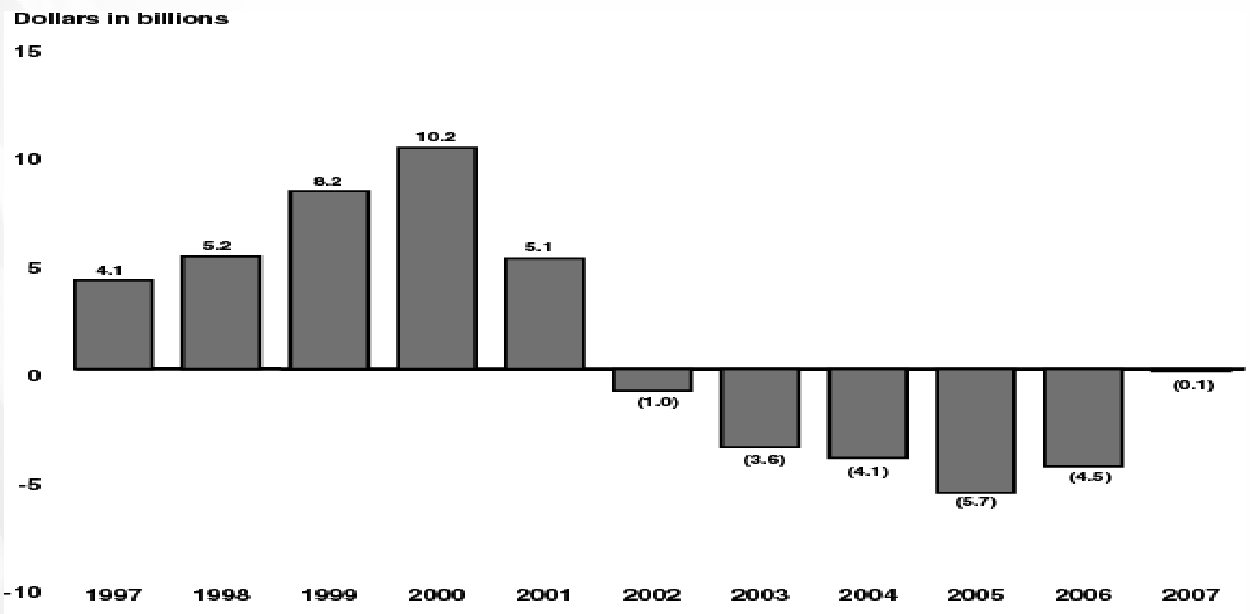
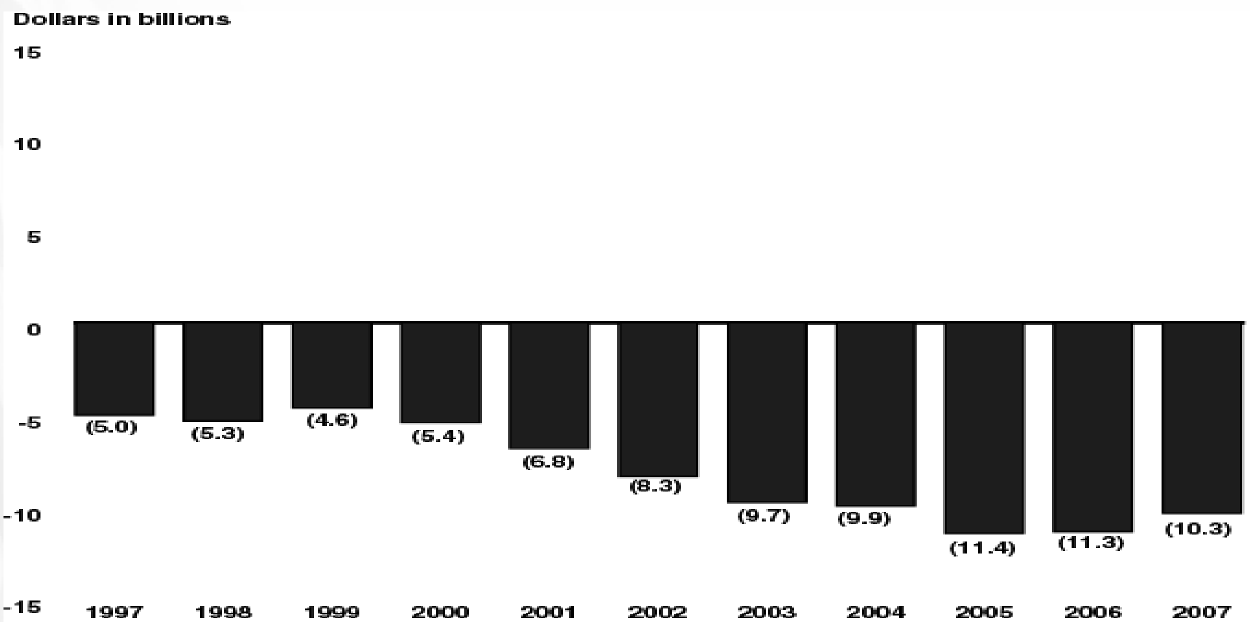
Figure 1: Funded Status of DOE Contractors' Defined Benefit Pension Plans, Fiscal Years 1997-2007



Source: DOE.

Figure 2: Funded Status of DOE Contractors' Postretirement Benefit Plans, Fiscal Years 1997-2007



Source: DOE.

Background: DOE Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy*

- To address its growing liabilities and concerns about market volatility and cost unpredictability, in fiscal year 2005, DOE negotiated the terms for three contracts (the Idaho Cleanup Project, the Advanced Mixed Waste Treatment Project, and the Idaho National Laboratory) for a single site that limited DOE's benefit cost reimbursements for new, or "nonincumbent," employees to a market-based benefits package that included defined contribution pension plans.
- In April 2006, DOE issued Notice 351.1, which laid out its policy for benefit cost reimbursements for all contractors. This notice:
    - distinguished between (1) incumbent employees, who were defined as eligible retirees and employees on the contractor's payroll prior to the date a market-based plan is established under the contract, and (2) new employees hired after this date; and
    - stated that DOE would continue to reimburse contractors for the allowable benefit costs for existing benefits for incumbent employees, subject to applicable laws and regulations.

Background: DOE Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy*

- Notice 351.1 provided that DOE would reimburse contractors for "market-based" pension and health benefit plans for new employees.
  - A pension plan was deemed "market-based" if (1) the pension plan was a defined contribution plan and (2) the benefit value and per capita cost of the contractor's pension plan and the total benefit package did not exceed the comparison group's average by more than 5 percent.
  - A health plan was deemed "market-based" if the benefit value and per capita cost of the contractor's health plan and the total benefit package did not exceed the comparison group's average by more than 5 percent.
- DOE stated that Notice 351.1's goals were to improve DOE's stewardship of taxpayer dollars by (1) mitigating the cost growth associated with benefit liabilities, (2) moderating the volatility and improving the predictability of DOE's cost reimbursement obligations for benefits, (3) ensuring that costs for contractor employee pension and medical benefits are more consistent with market trends, and (4) ensuring fairness to incumbent contractor employees.

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Background: DOE Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy*

- DOE suspended Notice 351.1 in June 2006 and decided not to reissue it in June 2007.
- It is no longer DOE's policy to (1) limit contractors' reimbursable pension benefit costs for new employees' to defined contribution plans or (2) compare the value <u>and</u> cost of the <u>individual</u> pension and health plans of a contractor with those of its comparison group.
- Order 350.1 remains DOE's controlling policy for reimbursing contractors' pension and postretirement benefit costs. DOE continues to follow the Order 350.1 provision that could limit reimbursement if a contractor's total benefit value <u>or</u> cost study score for <u>all</u> benefits exceeds the 105 percent benchmark of the comparison group, but is applying this provision primarily to new employees.

Objectives

The joint explanatory statement that accompanies the Consolidated Appropriations Act, 2008, directed us to assess the adequacy of DOE's analysis of pension and medical liabilities. Our objectives were to provide information on:

- DOE's analysis supporting its approval of the April 2006 policy changes in Notice 351.1,
- DOE's liabilities broken out by contractors' defined benefit pension and postretirement plan components and among its M&O and other site contracts, and
- DOE's recent actions to manage its future costs and liabilities.

Scope and Methodology

- Regarding DOE’s analysis supporting its approval of the policy changes contained in Notice 351.1, we reviewed information DOE provided to us in response to our request for any supporting documentation and decision documents related to the policy changes. We also interviewed DOE officials.
- Regarding the distribution of DOE’s liabilities for contractor defined benefit pension and postretirement plans, we reviewed plan data supporting the components of DOE’s liabilities reported in its fiscal year 2004-2007 financial statements, documentation of the work performed by independent auditors on DOE’s liabilities for those years, the trends in plan liabilities and costs, and information DOE provided to us in support of plan changes whose impact on plan obligations were reflected in fiscal years 2006 and 2007. We also interviewed DOE officials.

Scope and Methodology

- Regarding DOE's actions to manage future costs and liabilities, we reviewed policies for reimbursement of contractor pension and postretirement benefit costs in DOE Order 350.1 and DOE Notice 351.1. We also reviewed the employee benefit plan clauses included in M&O and other site contracts that were awarded between January 2005 and March 2008. We interviewed cognizant DOE officials to determine DOE's approach for revising contract clauses for pensions and postretirement benefits. Based on information that DOE provided to us, we also compiled a list of contractors whose most recent benefit value study score exceeded 105 percent of the average of their comparison group.

- We conducted our work from October 2007 through June 2008 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Limitations

- In doing this work, we limited our review to DOE's policies for reimbursing allowable contractor benefit costs.
- We also did not audit or verify data provided by DOE or its contractors for individual benefit plan activity and balances, although we determined that these data were in the aggregate consistent with amounts and other information in DOE's financial statements and sufficiently reliable for our purposes. In addition, we did not audit or verify the amount or timing of payments by DOE to its contractors for allowable benefit costs or any other costs.
- Further, the limited number of plan changes we reviewed did not provide a basis for a conclusion on DOE's internal controls over benefit plan changes.
- Our review of DOE's actions to manage future costs and liabilities did not include identifying all actions DOE may have taken or evaluating the nature, extent, or effect of any such actions. Further, we neither verified the accuracy of the results of the benefit value studies, nor did we evaluate contractors' conformance with DOE's requirements and guidance for the preparation of such studies.

DOE's Analysis Supporting Approval of Policy Changes in Notice 351.1

- Because DOE is ultimately responsible for reimbursing its contractors for allowable pension and postretirement benefit plan costs and records a liability or asset in its financial statements for the plans' funded status, it is important that DOE effectively oversee and monitor these programs.
- DOE's responsibility for overseeing and monitoring contractors is distributed across the organization and includes program, contracting, legal, financial, and other personnel at headquarters and site offices.
- *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1) provides guidance for management's ongoing monitoring of an organization's performance and the establishment and implementation of control activities to ensure that management's directives are carried out.

DOE's Analysis Supporting Approval of Policy Changes in Notice 351.1

- A program of oversight and monitoring can provide DOE management with the information necessary to, among other things, establish and adjust benefit policies, evaluate the effectiveness of cost control and liability management strategies, and evaluate the near- and long-term affordability of benefit plans.
- To understand DOE's process for making changes to contractor benefit policies, we requested DOE documentation of analyses conducted in support of the policy changes contained in its April 2006 Notice 351.1. These changes included the limitation that beginning no later than March 1, 2007, DOE would only reimburse contractors for the cost of "market-based" benefit programs, as defined in the Notice, for new employees. Market-based for pension plans meant that the plan was a defined contribution plan and the costs for the plan did not exceed market averages by greater than 5 percent. Health benefit plans were also considered market-based when costs did not exceed market averages by greater than 5 percent.

DOE's Analysis Supporting Approval of Policy Changes in Notice 351.1

- DOE officials told us that the decisions underlying the policy changes in Notice 351.1 were informed over a period of years by the trends in cost reimbursements, budgetary uncertainties, and by consulting actuaries and others, including DOE Inspector General reports and our reports.
- In response to our request for any supporting documentation and decision documents related to the April 2006 Notice 351.1, DOE provided us with information dated as early as March 2005, including internal memoranda and briefings, tables and calculations of historical and projected contractor benefit costs and liabilities, and correspondence with members of Congress and a briefing paper for congressional committees.
- This documentation demonstrates that DOE recognized the historical and possible future trend of its liabilities and costs related to contractor benefit plans.

DOE's Analysis Supporting Approval of Policy Changes in Notice 351.1

- However, DOE officials acknowledged that there was no formal, compiled record or summary analysis of the documentation and factors considered before Notice 351.1 was issued.
- We found that the documentation provided to us contained only limited evidence that DOE had considered policy alternatives, the sensitivities of stakeholders to the policy choices reflected in Notice 351.1, or the near- and long-term financial and mission impacts of the changes made.
- Further, the decision document reflecting the Deputy Secretary's approval of Notice 351.1 did not include the basis on which approval was recommended. However, DOE officials told us that issuance of the Notice adequately demonstrated evidence of internal consideration and senior-level approval of Notice 351.1.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans

- As of September 30, 2007, benefit obligations for DOE contractors' defined benefit pension and postretirement plans were about $27.5 billion and $10.5 billion, respectively. With assets of $27.4 billion and $161.6 million, the resulting net funded status (net liability) was $69.5 million and $10.3 billion for the pension and postretirement plans, respectively.

(Dollars in millions)

Components of funded status	Pension plans	Postretirement plans
Benefit obligations[a]	($27,512.9)	($10,480.2)
Assets[b]	27,443.4	161.6
Funded status (Net liability)	($ 69.5)	($10,318.6)

Source: GAO analysis of DOE and plan data

- Enclosures III and IV provide the *Distribution of the Funded Status of Defined Benefit Pension and Postretirement Plans for Fiscal Years 2007–2004*.

[a]Benefit obligations represent the actuarial present value of benefits attributable to employee service prior to the valuation date.
[b]Accounting standards require that plan assets, such as equity and debt securities, be valued at fair value.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans

- As discussed in the background section, DOE reimburses its contractors for allowable pension and postretirement benefit costs. Contractors' methods for funding these benefit costs – generally either by setting aside funds while employees are working (pension) or on a PAYGO basis after employees have retired (postretirement) – directly impact the funded status of the plans.
- The funded status – net (liability) or net asset – of DOE contractor benefit plans can change from one year to the next as benefits accrue and are paid. The funded status can also change due to other factors, including:
  - the amount of contractor contributions;
  - changes in actuarial assumptions, such as the interest rate used to discount expected future benefits to a present value;
  - plan experience, such as actual health care costs and returns on pension plan investments that are different than what was assumed; and
  - changes to benefits that employees receive or the portion of benefit costs borne by the employer.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans: Pension

- The net liability of DOE contractors' defined benefit pension plans at the end of fiscal year 2007 was $69.5 million. However, as shown in the table on the next page, 12 plans are overfunded and 34 plans are underfunded.
  - Of the 12 overfunded plans, 11 are sponsored by National Nuclear Security Administration (NNSA) and Office of Science contractors. These plans represent 98 percent of the $1.9 billion in pension overfunding, with the plans for three facilities representing 56 percent of the total overfunding.
  - Of the 34 underfunded plans, 9 are sponsored by Office of Environmental Management contractors. These plans represent 61 percent of the $2.0 billion in total pension underfunding, with the plans for two facilities representing 57 percent of the total underfunding.
- Enclosure V provides the *Components of the Funded Status of Defined Benefit Pension Plans for Fiscal Year 2007*.
- Enclosure VI provides the *Distribution of the Number of Defined Benefit Pension Plan Participants as of October 1, 2006.*
- Enclosure VII provides the *Distribution of the Funded Status of Defined Benefit Pension Plans by DOE Organization for Fiscal Years 2007–2004*.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans: Pension

Components of the Reported Funded Status of DOE's Contractors' Defined Benefit Pension Plans and Other Plan Information

Dollars in millions (except where stated otherwise)

	As of September 30, 2007		
Components of funded status	**All plans**	**Overfunded plans**	**Underfunded plans**
Benefit obligations	($27,512.9)	($16,741.1)	($10,771.8)
Assets	27,443.4	18,647.9	8,795.5
Funded status – Net (liability) asset	($ 69.5)	$ 1,906.8	($ 1,976.3)
Other plan information			
Number of plans	46	12	34
Number of participants (active / total, in thousands)[a]	77.7 / 180.0	28.4 / 75.0	49.3 / 105.0
Employer contributions	$387.4	$1.1	$386.3
Employee contributions	$3.0	$0.2	$2.8
Benefit payments	$1,311.5	$847.6	$463.9

Source: GAO analysis of DOE and plan data

[a]The number of participants are as of October 1, 2006.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans: Postretirement

- DOE's contractors sponsor various postretirement benefit plans. According to DOE, as of September 30, 2007, these included health (41 contractors), dental (19 contractors), life insurance (23 contractors), and Medicare Part B premium reimbursement (5 contractors).
- The net liability of DOE contractors' postretirement benefit plans at the end of fiscal year 2007 was $10.3 billion. This figure is net of $161.6 million in assets, $120.6 million of which is attributable to a life insurance plan for employees of a single facility.
- Enclosure VIII provides the *Distribution of the Funded Status of Defined Benefit Postretirement Plans by DOE Organization for Fiscal Years 2007–2004*.

Distribution of DOE's Liabilities for Contractors' Defined Benefit Plans: Approval of Plan Changes

- A key control step in monitoring contractors' benefit plans is the requirement that contractors provide DOE with documentation in advance for its review that shows the impact proposed plan changes have on employer contributions and relative benefit values, according to DOE officials.
- To understand DOE's process for approving plan changes, we reviewed the documentation supporting four plan changes whose financial effects were reflected in DOE's fiscal year 2006 and 2007 financial statements. For these four plan changes: one increased pension obligations by almost $4 million (0.2 percent of plan obligations), one reduced retiree health obligations by $105.8 million (7.8 percent of plan obligations), and two reduced retiree life insurance obligations by a total of $112.3 million (5.5 percent of plan obligations).
- DOE provided us with information submitted by contractors to support plan changes, including the following required by Order 350.1: (1) the effect of the plan change on the contract net benefit value or per capita benefit costs, (2) the dollar estimate of savings or costs, and (3) the basis for determining the estimated savings or costs.
- DOE approved all the requested plan changes in the limited sample that we reviewed; however, the documentation provided to us did not clearly reflect the basis on which DOE made its decisions to approve these plan changes.

Accountability * Integrity * Reliability

DOE's Actions to Manage Future Contractor Employee Benefit Costs and Liabilities

- DOE suspended Notice 351.1 in June 2006. It is no longer DOE's policy to restrict reimbursements for contractors' benefit costs for new employees only if
    - these employees participate in a "market-based" pension plan, which the Notice defined as a defined contribution plan; and
    - the benefit value and cost study scores of <u>individual</u> pension and health benefit plans for these employees do not exceed the 105 percent benchmark of the comparison group.
- Order 350.1 remains DOE's controlling policy for reimbursing contractors' pension and postretirement benefit costs. In addition, recent contracts
    - define "market-based" benefits to mean that all new employees' benefits do not exceed 105 percent of the comparison group's average total benefit value and cost study scores, and
    - direct contractors to perform a benefit value study every 2 years <u>and</u> a cost study annually to determine if contractor employees' pensions and benefits are market based.

DOE's Actions to Manage Future Contractor Employee Benefit Costs and Liabilities

- DOE has awarded 14 M&O and other site contracts that contain these new provisions for pension and postretirement benefits. DOE contractors have used different approaches to conform with DOE's contract provisions:
  - Contractors with benefit value scores well above the 105 percent benchmark have generally established two tiers of benefits: one market-based benefits plan for new employees and the existing plan or an equivalent for incumbents.
  - Contractors with benefit value scores close to the 105 percent benchmark have generally not established a second tier for new employees, but rather have slightly modified existing benefits for all employees. DOE has approved these modified benefits plans.

DOE's Actions to Manage Future Contractor Employee Benefit Costs and Liabilities

- Of the 14 contracts with the new provisions, NNSA awarded 2, Environmental Management awarded 6, and the Office of Science awarded 6. (See encl. IX.)
    - The two NNSA contractors have created a new second tier of benefits for new employees that provide 401(k)-defined contribution pension plans and eliminate the contractor's contribution to postretirement health benefits.
    - The six Environmental Management contractors have generally created a new second tier of benefits for new employees, usually involving a defined contribution pension plan.
    - The six Office of Science contractors generally have not established a second tier of benefits for new employees. Contractors already had benefit value scores which were below or slightly over the 105 percent benchmark.

DOE's Actions to Manage Future Contractor Employee Benefit Costs and Liabilities

- DOE's primary goal is to make employee benefits costs more predictable because, according to DOE officials, recent fluctuations in costs for contractors' employee pension benefits had made it difficult for DOE to reasonably estimate these costs when developing its annual budget proposals.
- DOE expects that these new provisions will not substantially affect pension and postretirement benefits costs and liabilities for the next 20 to 30 years because (1) they are only being included when contracts are being recompeted and (2) these changes are directed at new employees. Incumbents—eligible retirees and employees on a contractor's payroll before the new contract's effective date—will continue to receive their existing benefits, or a substantial equivalent. However, if the incumbent employees' total benefits package is over the 105-percent benchmark, the contractor may be required to submit and implement a Corrective Action Plan.

Enclosure II: DOE Contracts with Benefit Value Scores that Exceed DOE Order 350.1's Benchmark of 105 Percent

Facility	Responsible DOE Office	Date of most recent benefit value study[b]	Is a Corrective Action Plan in place?
Los Alamos National Laboratory	NNSA	January 2006	No. DOE reported that the benefit value score for market-based benefits included both new employee benefits and some incumbent employee benefits. When incumbent benefits are removed from the calculation, the benefit value score is below the 105 percent benchmark.
Lawrence Livermore National Laboratory	NNSA	May 2007	No. NNSA is waiting for results of future Benefit Value Study in summer 2008.
Sandia National Laboratories	NNSA	February 2006	No. NNSA has requested additional information on contractor's benefits.
Hanford site[a]	Environmental Management	August 2006	Yes.
Oak Ridge Environmental Management	Environmental Management	March 2005	Yes.
Argonne National Laboratory	Science	August 2007	No. Contractor raised employee contribution to health care premiums instead.
Fermi National Accelerator Laboratory	Science	June 2007	Contractor is currently developing Corrective Action Plan.
Lawrence Berkeley National Laboratory	Science	June 2006	No. Contractor is not required to implement Corrective Action Plan per OMB Circular A-121.
Thomas Jefferson National Accelerator Facility	Science	November 2007	No.

Source: DOE contractor benefit value studies.

[a]The Hanford site includes the following four site contracts: River Corridor Closure, 222-S Analytical Laboratory Services and Testing, Project Hanford Management, and River Protection Tank Farm.

[b]We are not providing the reported benefit value scores for these facilities because DOE believes that this information may be proprietary.

Enclosure III: Distribution of the Funded Status of Defined Benefit Pension Plans for Fiscal Years 2007-2004

Dollars in millions				
	Fiscal years			
Facility number[a]	2007	2006	2005	2004
1	($672.49)	($964.96)	($1,175.93)	($987.43)
2	(457.30)	(632.53)	(688.31)	(622.25)
3	(134.46)	(279.03)	(328.26)	(299.65)
4	(104.18)	(157.21)	(178.46)	(138.77)
5	(84.06)	(85.79)	(79.42)	(74.05)
6	(75.35)	(157.72)	(223.45)	(220.83)
7	(56.56)	(116.32)	(132.57)	(117.77)
8	(56.02)	(201.67)	(290.49)	(227.56)
9	(53.80)	(91.73)	(113.90)	(91.33)
10	(48.15)	(72.48)	(84.82)	(72.29)
11	(46.24)	(148.93)	(189.88)	(115.76)
12	(43.41)	(88.65)	(101.82)	(94.95)
13	(15.60)	(25.32)	(30.34)	(25.82)
14	(14.37)	(33.81)	(52.48)	(40.59)
15	(12.03)	(26.80)	(29.66)	(29.92)
16	(11.45)	(33.49)	(30.08)	(52.18)
17	(5.77)	(27.20)	(25.81)	(16.22)
18	(2.88)	(4.63)	(7.43)	(5.60)
19	(0.03)	(0.08)	(0.13)	(0.18)
20	0.20	0.17	0.18	0.19
21	14.74	(777.81)	(959.35)	(409.09)
22	30.18	18.46	16.14	20.40
23	105.36	(105.55)	(183.16)	(137.94)
24	278.48	29.49	(20.30)	10.62
25	392.84	(194.61)	(411.72)	(176.15)
26	466.19	(540.55)	(593.87)	(310.48)
27	536.63	219.52	195.21	118.20
Total	**($69.53)**	**($4,499.23)**	**($5,720.11)**	**($4,117.40)**

Source: DOE and plan data.

[a]DOE currently has 43 contracts for operations at DOE-owned facilities. The names of these facilities and other information that could identify a particular facility or contractor have been removed because DOE believes that the plans' funded status may be proprietary. Further, the funded status of all contractor plans was combined for purposes of reporting by facility. Consequently, there are facilities for which the overfunding and underfunding of different plans are netted even though the assets of one plan generally cannot be used to pay the benefits and other expenses of another plan. The data in this enclosure are presented in ascending order based on fiscal year 2007 funded status amounts. Data for facilities with a zero funded status for each of the fiscal years presented are not reflected in this enclosure. The facility numbers in this enclosure do not necessarily correspond to the same facilities as numbered in the report's other enclosures.

Enclosure IV: Distribution of the Funded Status of Defined Benefit Postretirement Plans for Fiscal Years 2007-2004

Dollars in millions

	Fiscal years			
Facility number[a]	2007	2006	2005	2004
1	($1,545.92)	($1,731.87)	($1,704.73)	($1,467.22)
2	(1,251.09)	(1,407.46)	(1,215.83)	(972.53)
3	(1,246.11)	(1,388.01)	(1,333.26)	(974.72)
4	(1,099.62)	(1,153.63)	(1,243.23)	(916.69)
5	(859.05)	(885.46)	(924.70)	(897.11)
6	(650.97)	(733.34)	(768.20)	(773.18)
7	(567.97)	(606.03)	(639.84)	(640.85)
8	(410.24)	(463.21)	(567.48)	(579.05)
9	(398.10)	(433.74)	(437.67)	(373.63)
10	(353.36)	(392.37)	(365.66)	(287.56)
11	(322.57)	(323.24)	(355.51)	(319.46)
12	(242.30)	(295.05)	(329.13)	(302.16)
13	(195.99)	(202.55)	(214.24)	(178.81)
14	(179.47)	(201.76)	(217.63)	(229.83)
15	(143.45)	(155.19)	(162.73)	(159.76)
16	(116.38)	(123.30)	(176.38)	(155.81)
17	(111.52)	(113.62)	(115.85)	(99.67)
18	(98.36)	(116.96)	(113.49)	(101.07)
19	(93.74)	(88.91)	(63.36)	(52.09)
20	(71.27)	(80.25)	(84.50)	(80.42)
21	(61.76)	(62.12)	0.00	0.00
22	(59.86)	(84.72)	(86.13)	(78.39)
23	(58.48)	(83.63)	(100.46)	(86.76)
24	(54.23)	(56.38)	(61.00)	(54.59)
25	(41.34)	(43.28)	(42.05)	(37.64)
26	(29.14)	(34.37)	(23.50)	(26.88)
27	(17.98)	(24.10)	(20.52)	(13.01)
28	(13.39)	(19.41)	(20.76)	(19.49)
29	(9.14)	(10.02)	(10.99)	(10.61)
30	(8.10)	(9.38)	(9.55)	(7.83)
31	(8.00)	(9.44)	(18.05)	(12.37)
32	(5.61)	(7.27)	(12.81)	(9.52)
33	(4.71)	(5.41)	(4.74)	(3.79)

Dollars in millions

	Fiscal years			
Facility number[a]	**2007**	**2006**	**2005**	**2004**
34	(0.06)	(0.12)	(0.16)	(0.19)
35	10.64	9.57	9.70	10.24
Total	**($10,318.64)**	**($11,336.03)**	**($11,434.44)**	**($9,912.45)**

Source: DOE and plan data.

[a]DOE currently has 43 contracts for operations at DOE-owned facilities. The names of these facilities and other information that could identify a particular facility or contractor have been removed because DOE believes that the plans' funded status may be proprietary. The data in this enclosure are presented in ascending order based on fiscal year 2007 funded status amounts. Data for facilities with a zero funded status for each of the fiscal years presented are not reflected in this enclosure. The facility numbers in this enclosure do not necessarily correspond to the same facilities as numbered in the report's other enclosures.

Enclosure V: Components of the Funded Status of Defined Benefit Pension Plans for Fiscal Year 2007

Dollars in millions

Facility number[a]	Funded status: Benefit obligation	Assets	Net
1	($2,126.58)	$1,454.09	($672.49)
2	(1,555.38)	1,098.08	(457.30)
3	(1,103.29)	968.83	(134.46)
4	(450.11)	345.93	(104.18)
5	(62.37)	(21.69)	(84.06)
6	(471.56)	396.21	(75.35)
7	(437.27)	380.71	(56.56)
8	(829.44)	773.42	(56.02)
9	(361.78)	307.98	(53.80)
10	(315.85)	267.70	(48.15)
11	(723.47)	677.23	(46.24)
12	(338.34)	294.93	(43.41)
13	(61.15)	45.55	(15.60)
14	(121.22)	106.85	(14.37)
15	(65.87)	53.84	(12.03)
16	(86.02)	74.57	(11.45)
17	(37.36)	31.59	(5.77)
18	(19.23)	16.35	(2.88)
19	(0.03)	0.00	(0.03)
20	(0.42)	0.62	0.20
21	(5,012.96)	5,027.70	14.74
22	(110.47)	140.65	30.18
23	(1,338.10)	1,443.46	105.36
24	(1,561.92)	1,840.40	278.48
25	(3,624.98)	4,017.82	392.84
26	(5,349.04)	5,815.23	466.19
27	(1,348.72)	1,885.35	536.63
Total	**($27,512.93)**	**$27,443.40**	**($69.53)**

Source: DOE and plan data.

[a]DOE currently has 43 contracts for operations at DOE-owned facilities. The names of these facilities and other information that could identify a particular facility or contractor have been removed because DOE believes that the plans' funded status may be proprietary. Further, the funded status of all contractor plans was combined for purposes of reporting by facility. Consequently, there are facilities for which the overfunding and underfunding of different plans are netted even though the assets of one plan generally can not be used to pay the benefits and other expenses of another plan. The data in this enclosure are presented in ascending order based on net funded status amounts. Data for facilities with a zero funded status for each of the fiscal years presented are not reflected in this enclosure. The facility numbers in this enclosure do not necessarily correspond to the same facilities as numbered in the report's other enclosures.

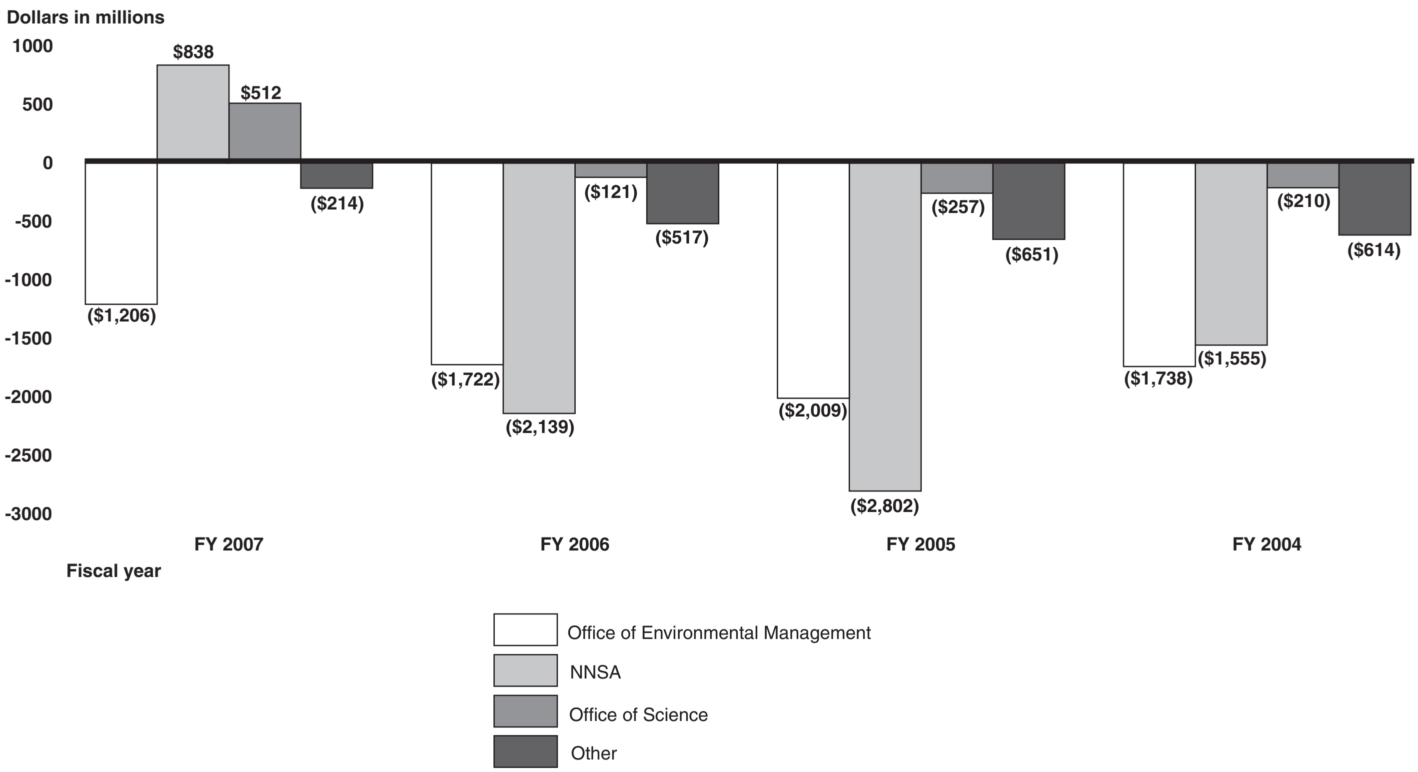
Enclosure VI: Distribution of the Number of Defined Benefit Pension Plan Participants as of October 1, 2006

Facility number[a]	Active	Retired, disabled, and other beneficiaries	Terminated, vested, and other	Total
1	6,611	4,552	9,509	**20,672**
2	9,123	5,068	3,937	**18,128**
3	9,655	6,261	1,682	**17,598**
4	6,913	5,282	2,832	**15,027**
5	4,825	7,654	1,808	**14,287**
6	7,476	4,381	1,698	**13,555**
7	5,087	4,241	1,058	**10,386**
8	4,784	3,714	1,529	**10,027**
9	2,707	4,852	1,476	**9,035**
10	2,409	3,215	2,497	**8,121**
11	0	3,976	3,796	**7,772**
12	3,754	1,530	1,297	**6,581**
13	2,933	1,327	1,116	**5,376**
14	2,275	1,282	1,114	**4,671**
15	2,827	899	548	**4,274**
16	3,018	835	272	**4,125**
17	996	636	466	**2,098**
18	31	656	787	**1,474**
19	841	148	448	**1,437**
20	0	653	774	**1,427**
21	216	522	281	**1,019**
22	172	263	488	**923**
23	549	108	195	**852**
24	332	143	342	**817**
25	112	33	212	**357**
26	51	0	52	**103**
27	0	8	0	**8**
	77,697	**62,239**	**40,214**	**180,150**

Source: DOE and plan data.

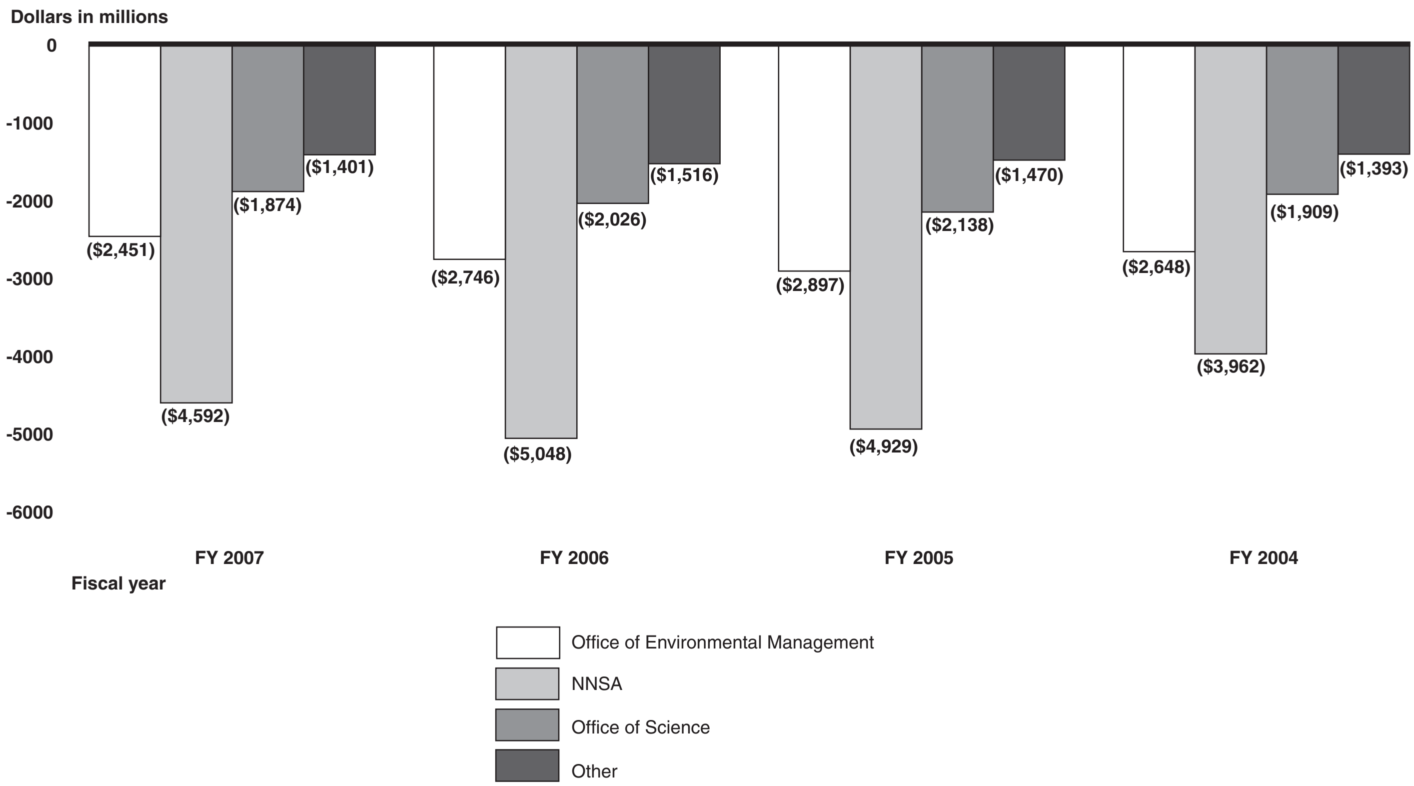
[a]DOE currently has 43 contracts for operations at DOE-owned facilities. The names of these facilities and other information that could identify a particular facility or contractor have been removed because DOE believes that the number of plan participants may be proprietary. Further, the participants of all contractor plans were combined for purposes of reporting by facility. The data in this enclosure are presented in descending order based on total participants. Data for facilities with a zero funded status for each of the fiscal years presented are not reflected in this enclosure. The facility numbers in this enclosure do not necessarily correspond to the same facilities as numbered in the report's other enclosures.

Enclosure VII: Distribution of the Funded Status of Defined Benefit Pension Plans by DOE Organization for Fiscal Years 2007-2004



Sources: GAO analysis of Department of Energy and plan data.

Enclosure VIII: Distribution of the Funded Status of Defined Benefit Postretirement Plans by DOE Organization for FY 2007-2004



Source: GAO analysis of Department of Energy and plan data.

Enclosure IX: DOE's Contracts that Contain the New Pension and Postretirement Benefit Provisions

These contracts contain language defining market-based benefits to mean that new employees' total benefits do not exceed 105 percent of the comparison group's average total benefit value score along with directing that the contractors conduct a benefit value study every 2 years and a cost study annually.

Responsible DOE Office	Facility	Award date
NNSA	Los Alamos National Laboratory	June 1, 2006
NNSA	Lawrence Livermore National Laboratory	May 8, 2007
Environmental Management	Portsmouth Remediation	January 10, 2005
Environmental Management	Portsmouth Infrastructure	March 16, 2005
Environmental Management	Paducah Infrastructure	March 16, 2005
Environmental Management	Paducah Remediation	December 27, 2005
Environmental Management	West Valley Demonstration Project	June 29, 2007
Environmental Management	Savannah River Site	January 10, 2008
Science	Oak Ridge Institute for Science and Education	December 21, 2005
Science	Thomas Jefferson National Accelerator Facility	April 14, 2006
Science	Argonne National Laboratory	July 31, 2006
Science	Fermi National Accelerator Laboratory	November 1, 2006
Science	Ames Laboratory	December 4, 2006
Science	Oak Ridge Protective Services	May 3, 2007

Source: DOE.

Note: Since January 2005, DOE has awarded eight additional management and operating (M&O) or other site contracts that do not contain both of DOE's new pension and postretirement benefit provisions: the Idaho Advanced Mixed Waste Treatment Plant, Idaho Cleanup Project, Idaho National Laboratory, Nevada Test Site M&O, Nevada Test Site protective services, the Hanford 222-S Analytical Laboratory Services and Testing, Hanford River Corridor Closure, and Lawrence Berkeley National Laboratory. As of March 2008, DOE was competing five additional contracts that contain these new pension and postretirement benefit provisions: Hanford Mission Support, Hanford Plateau Remediation, Hanford Tank Operations, Savannah River Liquid Waste Contract, and National Renewable Energy Laboratory.

Enclosure X: Comments from the Department of Energy

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Department of Energy
Washington, DC 20585

May 15, 2008

Mr. Mark E. Gaffigan
Director
Natural Resources and Environment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: **GAO Review of Department of Energy (DOE) Reimbursement of Contractor Employee Benefits**

Dear Mr. Gaffigan:

Thank you for the opportunity for the DOE to review the draft letter and accompanying enclosures from the Government Accountability Office (GAO) to the Chairmen and Ranking Members of the Senate and House Subcommittees on Energy and Water Development ("GAO Letter"). In addition to the draft GAO Letter, we also have reviewed the draft slides that GAO used to brief the subcommittees in March 2008 ("GAO Slides").

Pursuant to discussions between our staff members, we have provided suggested comments on these documents. Many of these suggestions were meant to clarify information presented as well as make the presentation of the same information in various places consistent. We also provided comments in the text of the letter to explain some suggestions.

See comment 1.

In addition, pursuant to agreement with your office, GAO will redact information as agreed on by GAO and DOE in draft Enclosures III, IV, V, VI and on page 22 of the GAO Slides for versions of these documents made publicly available. This is because these documents contain information that may be considered confidential and/or proprietary and thus may not be available to the public because it may be protected by one or more exemptions under the Freedom of Information Act. GAO also agrees that any unredacted versions of these documents that are submitted to Congress will contain appropriate markings to the effect that the marked information being submitted may be considered confidential and/or proprietary and should not be further disseminated.

See comment 2.

Further, please be advised that for draft Enclosures VII and VIII, DOE did not verify the funded status of pension and Post Retirement Benefits (PRB) plans by program. For financial statement purposes, DOE compiles individual contractor pension and PRB benefit plan information by contractor plan rather than by program.

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See comment 3.

DOE would also like to point out that throughout the draft GAO Letter, the accompanying enclosures and the draft GAO Slides, the "funded status" of DOE contractor defined benefit pension plans is reported as a single amount, both for each site and for the Department as a whole for Fiscal Years (FY) 2004-2007. It is misleading to report the funded status as a single amount for DOE sites at which one or more contractors sponsor more than one defined benefit pension plan. For example, where a site has two defined benefit pension plans, one of which is overfunded and the other is underfunded, reporting the funded status only as a single amount is misleading because the overfunding of one defined benefit pension plan cannot be used to offset the underfunding of a separate defined benefit pension plan. Thus, netting the two amounts is not an accurate reflection of DOE's obligation relating to the funded status of the underfunded plan.

On a larger scale, for example, in Enclosure III, the FY 2007 funded status for the total of DOE contractor defined benefit pension plans (i.e., underfunding of $69.53M) represents the net of the aggregate of the underfunded plans totaling approximately $2 billion and the aggregate of overfunded plans totaling approximately $1.9 billion. Another example is on page 2 of the draft GAO Letter which references "a net liability of $69.5M for defined benefit pensions . . . ." Though DOE also discloses the funded status for the total of contractor defined benefit plans, I want to make clear that the Department cannot offset underfunding in one contractor defined benefit pension plan with overfunding in another contractor defined benefit pension plan. Therefore, the true amount of underfunding of DOE's contractor defined benefit pension plans for FY2007 is approximately $2 billion, not $69.53 million. The Department is concerned that without additional explanation, readers of the GAO report may believe that the Department's total reported liability for DOE contractor defined benefit pension plans in FY 2007 is $69.53 million instead of approximately $2 billion.

See comment 4.

Overall, the Department believes that the draft report correctly reflects the status of Departmental policy regarding reimbursement of contractor employee benefits for 43 Management and Operating (M&O) and other site contracts. However, as discussed below, the Department disagrees with the draft report's implication that the issuance on April 27, 2006, of DOE Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy,* was not based on considered analysis.

The Department's main concern with the proposed draft GAO Letter and draft GAO Slides are the descriptions of the basis for the issuance of DOE Notice 351.1, *Contractor Employee Pension and Medical Benefits Policy* on page 5 of the draft GAO Letter and page 20 of the draft GAO Slides. Under "Results in Brief" on page 5 of the draft GAO Letter, the first sentence states that "DOE officials told us that the decisions underlying the policy changes in it's April 2006 Notice 351.1 were formed over a period of years by the trends in cost reimbursements, budgetary uncertainties, and by consulting actuaries and others, include DOE Inspector General reports and our reports." This is a correct statement. However, we do not agree with GAO's conclusion that there is only "limited evidence" that DOE had considered policy alternatives, the sensitivities of stakeholders and the near- and long-term financial and mission impacts of the proposed changes. While it is true that the Department did not compile a "formal record" of its work leading up to issuance of DOE Notice 351.1, the Department provided GAO with considerable evidence that DOE Notice 351.1 was the result of documented long-standing Departmental concerns about the growing liability of the Department for contractor employee benefit costs.

The upward trends in DOE's reimbursement of contractor employee benefits are well evidenced by the Statement of Financial Accounting Standards (SFAS) No. 87, "Employers Accounting for Pensions," and SFAS No.106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (both as amended by SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans") reports which are provided each year by contractors to the Department and which were made available to the GAO for review. Among other documents, GAO was provided with a copy of a briefing package for the Secretary of Energy dated March 1, 2005, entitled: "Overview: DOE Contractor Pension and Post Retirement Benefit Liability." Among other information included in that package was a chart entitled "DOE Contractor Pension & Post Retirement Benefits Unfunded Projected Benefit Obligation Trend FY92-FY04." It also included a chart entitled "Current DOE Costs for Pension Contributions and PRB Expenses" fiscal year for the years 2000 through 2004 and estimated costs for 2005 and 2006.

GAO was also provided a copy of a letter dated August 10, 2005, from Secretary Bodman to Senator Pete V. Dominici, Chairman of the Senate Committee on Energy and Natural Resources, that referenced the Department's comprehensive assessment of Departmental policies regarding pension benefits and post-contract retiree medical benefits and the decision to develop "an overall long-term strategy to mitigate liability growth in existing plans and channel new contractor employees into cost predictable plans that are more consistent with current industry practice and trends." We also provided GAO with a copy of a briefing paper dated January 27, 2006, prepared for the Senate Energy and Natural Resources Committee and the Senate Energy and Water Development Subcommittee, entitled "DOE Facility Management Contractor Benefit Costs & Long Term Liabilities," which demonstrate that the Department – and Congress – were aware of and concerned about these long-term liabilities. In addition, we provided GAO with a February 18, 2006, memorandum from the Director of the Office of Management to then Deputy Secretary Clay Sell, which stated as its purpose at the beginning "to report on the status of the Department's initiative to effect changes in contractor employee pension/health benefits policy." All of these documents show that a great deal of considered work and analysis formed the basis for issuance of DOE Notice 351.1.

See comment 5.

We would also like to make two other comments. DOE does not "exempt" contracts from a Corrective Action Plan. As noted on page 5 of the draft GAO Slide "Background: Reimbursement of Contractor Pension and Postretirement Benefit Costs," pursuant to DOE

See comment 6.

Order 350.1 the Contracting Officer has discretion to determine whether such a plan is necessary. See also page 3 of the draft GAO Letter. In addition, the draft GAO Letter on page 6 discusses why the funded status of contractor employee defined benefit pension plans may fluctuate significantly from year to year. However, a key reason for such fluctuations is missing, which is that the market may go down significantly and unpredictably as well as up.

If you have any questions about the above information, please do not hesitate to contact me at 202-287-1310.

Sincerely,

Edward R. Simpson
Director
Office of Procurement
and Assistance Management

The following are GAO's comments on the Department of Energy's letter dated May 15, 2008.

GAO Comments

1. In response to DOE's concern that the funded status and benefit value scores of contractor benefit plans may be proprietary, we have redacted from this report information that could associate a funded status amount or benefit value score with a particular facility or contractor.

2. We understand that for financial reporting purposes DOE compiles benefit plan information by contractor and not by program. We also understand that DOE did not verify our mathematical aggregation of the funded status of benefit plans according to the program offices responsible for overseeing the contractors that sponsor these plans. Our aggregations of funded status were based on a list of facilities and contractors and their associated program offices that DOE provided us. Although we did not audit or verify data provided by DOE or its contractors for individual benefit plan activity and balances, we did determine that plan data were, in the aggregate, consistent with amounts and other information in DOE's financial statements and, therefore, sufficiently reliable for our purposes.

3. We disagree with DOE's comment that it is misleading to report the funded status of DOE contractor defined benefit pension plans as a single amount. The funded status amounts we report represent a disaggregation of amounts previously reported by DOE for its contractors' pension and postretirement benefit plans in financial statements required by the Chief Financial Officers Act. Our reporting of funded status amounts for these liabilities by DOE facility and by DOE program provide accurate information at a point in time – subject to any limitations that may exist in the underlying data – on such amounts at the level it is presented. Further, the briefing slides present the benefit obligations, assets, and funded status of contractor pension plans separately for overfunded plans and underfunded plans at September 30, 2007 (see encl. I). This presentation clearly shows that the contractor pension benefit obligations to which DOE is committed to funding total $27.5 billion and that 34 of 46 contractor pension plans are underfunded by a total of almost $2 billion. We state in our report that we determined that these data were sufficiently reliable for our purposes. However, to address DOE's concern, we clarified enclosures III and V to state that the funded status of all contractor plans were combined for purposes of reporting by facility and that assets of one

plan generally cannot be used to pay the benefits and other expenses of another plan.

4. Regarding DOE's disagreement with the implication that the issuance of Notice 351.1 was not based on considered analysis, we continue to believe that the materials that DOE provided to us contained only limited evidence that DOE had considered policy alternatives, the sensitivities of stakeholders to the policy choices reflected in Notice 351.1 or the near- and long-term financial and mission impacts of the changes made. (See the Agency Comments and Our Evaluation section.) Not even the decision document reflecting the Deputy Secretary's approval of Notice 351.1 included the basis on which approval was recommended. The bottom line is that the connection between what DOE cites as evidence of its concerns and its policy changes as reflected in Notice 351.1 is not readily apparent from the documents DOE provided us as shown by the following three items and by the timing of DOE's actions. First, DOE provided us with copies of contractor-prepared actuarial reports that, according to the department, amply document the upward trends in DOE's reimbursement of contractor employee benefits. However, the actuarial reports DOE provided to us consisted largely of historical quantitative information. The reports prepared by DOE's contractors demonstrated that DOE had a process for routinely compiling information necessary for its annual financial statements. Second, DOE provided us with March 2005 briefing slides used for a presentation to the Secretary of Energy entitled "Overview: DOE Contractor Pension and Post Retirement Benefit Liability" that included two charts with benefit program data. However, these two charts, as with the rest of the information in the briefing document, principally provided background and historical data and a listing of possible approaches for managing contractor benefit liabilities. No explanation was provided of how these data and approaches were considered in making the policy choices as reflected in Notice 351.1. Third, DOE provided us an August 10, 2005, letter from the Secretary of Energy to the Chairman of the Senate Committee on Energy and Natural Resources that referred to a comprehensive assessment of departmental policies regarding pension benefits and post-contract retiree medical benefits and the decision to develop "an overall long-term strategy to mitigate liability growth in existing plans and channel new contractor employees into cost predictable plans that are more consistent with current industry practice and trends." However, DOE did not provide us with evidence of a completed comprehensive assessment.

Overall we found that the documentation that DOE provided to us was not responsive to our targeted request for documentation of analyses conducted in support of the policy changes contained in Notice 351.1. We found limited evidence of what should have been a process of thorough analysis of such an important issue as changes to DOE policy on contractor employee pension and medical benefits. We were provided historical accounting and actuarial information, general information about benefit program issues from industry specialists, DOE responses to queries from elected officials, and DOE internal briefing documents that provided overview information on contractors' pension and other postretirement benefit plans. However, the documents provided to us did not include a comprehensive assessment of existing DOE policies, an analysis of the potential impacts of alternative strategies for managing contractor benefit plan liabilities, or an indication of the information that senior DOE management may have relied on when developing the policy changes contained in Notice 351.1. As stated in our report, the documentation that DOE provided to us demonstrates that DOE recognized the historical and possible future trend of its liabilities and costs related to contractor benefit plans. However, we found no linkage between this basic awareness and the actions taken by DOE in Notice 351.1. Finally, the timing of DOE's actions on this matter is inconsistent with its assertion that considerable work and analyses was the basis for issuance of Notice 351.1. Two months after its April 2006 issuance, DOE suspended Notice 351.1. About 9 months later, in March 2007, DOE issued a notice in the *Federal Register* seeking for the first time public comment on *DOE Contractor Employee Pension and Medical Benefits Challenge*. In response to stakeholder and congressional concerns, DOE decided not to reissue Notice 351.1 in June 2007.

5. We have revised the report to state that a DOE contracting officer may require a Corrective Action Plan if the value of an M&O contractor's benefit plans exceeds the 105-percent threshold set forth in Order 350.1.

6. We disagree with DOE's comment that we omitted market volatility as a key reason why defined benefit pension plans may fluctuate significantly from year to year. We have clearly cited market volatility as a reason for fluctuations in the funded status of DOE contractor defined benefit pension plans, both up and down. For example, the briefing slides state that the funded status of contractors' defined benefit plans declined rapidly from 2001 through 2005 and that the funded status of defined benefit pensions can fluctuate significantly from one year to the next (see encl. I). The briefing slides also state

that the funded status of such plans can change from one year to the next due to factors that include “returns on pension plan investments that are different than what was assumed.”

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