U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

AUDIT REPORT

Management of Selected Department of Energy Contractors' Health and Post-Retirement Benefits

OAI-M-16-15

August 2016

Department of Energy
Washington, DC 20585

August 4, 2016

MEMORANDUM FOR THE HEAD OF CONTRACTING ACTIVITY, OFFICE OF SCIENCE
ASSOCIATE ADMINISTRATOR FOR ACQUISITION AND PROJECT MANAGEMENT, NATIONAL NUCLEAR SECURITY ADMINISTRATION

Michelle Anderson

FROM: Michelle Anderson
Assistant Inspector General for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on the "Management of Selected Department of Energy Contractors' Health and Post-Retirement Benefits"

BACKGROUND

The Department of Energy relies on contractors to perform a substantial part of its mission and reimburses its contractors for employee labor and benefit costs incurred. Employee benefits are a significant portion of contractor costs. In fiscal year (FY) 2013, the Department spent approximately $3.3 billion on contractor employee benefits, and that amount is expected to grow to $4 billion by FY 2019.

According to Department officials, a number of activities are conducted to evaluate contractors' health and post-retirement benefit costs. Contractors submit annual reports to the Department regarding management of these costs. Department Order 350.1, *Contractor Human Resource Management Programs,* was established, in part, to improve the cost effectiveness of contractor human resource management programs. The current version of the Order directs Department and National Nuclear Security Administration (NNSA) officials to ensure that health and post-retirement benefits are reasonable based on the results of a benefit value study and a cost study. The Order also sets a benchmark for both types of studies at 105 percent of the comparator population's benefits and costs. In 2004, the Government Accountability Office recommended that these studies be extended to all contractor locations. Due to the significant expenditures for contractor benefits, we performed this audit to determine whether the Department's contractors were effectively managing health and post-retirement benefits. We limited our review to the contractors' benefit value and cost study activities at selected sites.

RESULTS OF AUDIT

We found that three of the four contractors in our review prepared cost studies that did not completely follow Department guidance for complying with Department Order 350.1 or with associated contract requirements. The fourth contractor did not complete a cost study because NNSA was unable to incorporate the current version of Department Order 350.1 into the contract. According to an NNSA official, NNSA and its contractor could not agree upon several issues, which made it more practical to wait for an upcoming contract re-competition. In addition, one of the four contractors did not follow Department guidance for preparing its benefit value study, while a second contractor was not required to take appropriate corrective action in response to its study.

The current version of Department Order 350.1 establishes the use of two tools to evaluate whether contractor health and post-retirement benefits are reasonable, and we noted that most sites had incorporated these requirements into their contracts. One tool is a benefit value study, a tool that measures the relative worth of contractor benefits compared to industry. The other tool is a cost study that evaluates contractor employee benefit costs against a comparator population from the U.S. Bureau of Labor Statistics (BLS) or a professionally recognized survey. In June 2013, the Department issued Acquisition Letter AL-2013-09, which directed Contracting Officers to follow the Department Order 350.1 requirement to use these tools by incorporating them directly into management and operating contract clauses. Although Department Order 350.1 provides an exception to this requirement for contractors with corporate benefits (i.e., university contracts), the Department incorporated this requirement directly into the university-based contracts we reviewed.

Department officials also noted that they use additional tools, such as the Department's *Contractor Benefits Benchmarking and Metrics Study*. Unlike the contractor-specific cost and benefit studies that use national or regional comparator populations, as appropriate, to achieve a reasonable comparison, the Department study compares health and post-retirement benefit costs among Department contractors as well as to nationwide industry benchmarks. However, the benefit value study and the cost study are the only tools required by Department Order 350.1 or contract terms to measure compliance with the Department's 105 percent standard.

Although the Order and most of the contracts require these studies, they do not provide specific instructions on how they should be performed. Different methodologies could result in inconsistent and inaccurate results. Therefore, we looked for the best available criteria for complying with Department Order 350.1 and contract terms and found that the Department's *Cost Study Manual* and *Value Study Desk Manual* provided detailed guidance for Contracting Officers regarding how contractors were to prepare required benefit value and cost studies and develop any necessary corrective action plans. For example, the *Cost Study Manual* recommended that contractors perform annual cost studies that included major benefit subcategories such as post-retirement benefits service cost, contained grandfathered employees (employees who are exempt from changes to certain contract benefits such as post-retirement health care), and used an appropriate comparator population. Although not mandated by the Order or contract terms, in our view the guidance provides Department and NNSA sites with a reasonable process to achieve reliable results from their cost studies and value studies.

Cost Studies

We found that three of the four contractors we reviewed had not completed cost studies consistent with Department requirements or guidance. In addition, the fourth contractor did not complete a cost study because it was not required in its contract. Specifically, we found that:

- Lawrence Berkeley National Laboratory (LBNL) used a comparator population other than what was recommended by the Department to measure the reasonableness of costs in comparison to the benefits provided and, furthermore, did not fully justify the use of this alternative population;

- SLAC National Accelerator Laboratory (SLAC) did not calculate the cost of post-retirement benefits service costs;

- Lawrence Livermore National Laboratory (LLNL) omitted critical elements in cost studies; and

- Sandia National Laboratories (SNL) did not perform any cost studies at all.

As noted in the previous Office of Inspector General report *Follow-up Audit of Health Benefit Costs at the Department's Management and Operating Contractors* (DOE/IG-0470, May 2000), a cost study is necessary to evaluate the cost effectiveness of health and post-retirement benefits programs.

Lawrence Berkeley National Laboratory

LBNL's calendar year (CY) 2012 cost study used the costs associated with a comparator population other than what was recommended by the Department to measure whether costs were reasonable in comparison to the benefits provided. Furthermore, it did not fully justify the use of this alternative population. Even though the *Cost Study Manual* identified commercial manufacturing as the most comparable industry to a typical Department contractor, LBNL's cost study compared the cost of benefits provided to a group of state and local government employees to the cost of benefits provided to LBNL employees because its management and operating contractor was a state university. However, the Department's *Cost Study Manual* specifies comparator populations should be of comparable industry type and size. In our view, state employees are not of comparable industry type and size to the highly technical population employed at LBNL. We noted that there is no formal Department requirement for the cost study and benefit value study populations to be the same. However, Department guidance for both types of studies states that the comparator and contractor populations should be similar.

To LBNL's credit, the consultant who performed LBNL's benefit value study used a comparator population that appeared to be representative of the LBNL population. LBNL selected 15 organizations for comparison purposes in its benefit value study, which included six manufacturing companies, six private universities and three Department site contractors. However, unlike the benefit value study, the comparator population LBNL used to prepare its cost study did not align closely with the contractor's population, as recommended by Department guidance. Benefit value and cost studies that incorporate populations that are comparable to LBNL's population are important to ensure that the Department paid competitive market rates for employee benefits.

We noted that the Department required LBNL to justify the 2012 cost study comparator population change, as recommended in the Department's *Cost Study Manual*. LBNL officials told the Department that they used the state and local government employees for the cost of benefits comparison because they believed LBNL's benefits were more aligned with state government benefits than a typical Department contractor. However, LBNL did not address how its population was comparable to the selected state and local government employee population. Contrary to the *Cost Study Manual*, LBNL looked for a comparator population with comparable benefits, rather than focusing on finding populations of comparable industry type and size. Because LBNL is managed by a university in the research and development industry, it could have considered the population within the BLS industry category of "Junior Colleges, Colleges, and Universities." Another reason cited by LBNL to justify the change was to maintain alignment of its benefits with those of the University of California. However, LBNL provided no data to support how such a position was relevant to the Department.

We found that the comparator population LBNL used did reduce its 2012 total cost study result from 133.7 to 115.3 percent of the industry average cost. While this amount exceeded the Department standard of 105 percent, the Department accepted the cost study result as a justification to avoid requiring a corrective action plan because it was significantly lower than the prior year cost study result, which was 140.7 percent of the industry average. However, had LBNL used a more closely aligned comparator population, the Department would have had a more accurate gauge for assessing the effectiveness of LBNL's benefit program management and for determining whether a corrective action plan was appropriate.

SLAC National Accelerator Laboratory

According to the *Cost Study Manual*, the service cost for post-retirement benefits is a key component of the cost study. SLAC's CY 2013 cost study included a service cost for post-retirement benefits that was obtained from an outdated 2012 pension management report. We could not determine if this resulted in a material error. However, because the amount was derived from an outdated report, the results of SLAC's cost study were not completely valid and, therefore, the cost study was not as useful as it could be to the Department for calculating the costs of benefit plans and assessing SLAC's performance in managing its health and post-retirement benefits.

Stanford University (Stanford) manages SLAC for the Department. Stanford officials told us they had ceased reporting the post-retirement benefit service cost amount to the Department in 2013 and planned to exclude it from future cost studies because of a new contract requirement that limited the Department's post-retirement benefit liability in the event of contract cancellation. However, when we pointed out the contract clause that included a post-retirement benefit service cost reporting requirement, management committed to incorporating the post-retirement benefit service cost into future cost studies.

Lawrence Livermore National Laboratory

LLNL prepared a cost study that lacked several significant elements. For instance, LLNL's cost study did not indicate how its benefits compared to the 105 percent standard, as required by its contract clause "Workforce Transition, Contractor Compensation, Benefits and Pension." The cost study also did not divide costs into major subcategories and, while not contractually required, did not provide post-retirement service costs for grandfathered employees, as recommended by the Department's *Cost Study Manual*.

LLNL's cost study did not indicate how its benefits compared to the 105 percent Department standard, which is critical because it is a contract requirement and is the fundamental performance metric of Department Order 350.1. LLNL officials stated they did not require the study to address compliance with the 105 percent standard because they could make their own compliance calculation from the cost study results and include them in a cover letter to NNSA. However, LLNL subcontracted the performance of its cost study to a consultant. The supporting data used by the consultant was not disclosed to LLNL or us for review because it was considered proprietary. In our opinion, this increases the risk of error when an organization other than the study's original author, such as LLNL, has to make further calculations to complete the analysis without an understanding of the underlying data. Furthermore, the *Cost Study Manual* specifies that consultant analysis should result in a cost study index number to compare with the 105 percent standard. The Contracting Officer agreed that LLNL should require the consultant to make the complete analysis and final determination. According to NNSA, this change has been implemented.

Although the *Cost Study Manual* specifically recommends that cost studies include grandfathered employees, LLNL's contract excludes grandfathered employees from the cost study methodology. Instead, it considers "substantially equivalent" benefits as reasonable. As a result, $25 million in post-retirement benefits for nearly half of LLNL's 5,800 employees were not subject to this additional, more structured analysis.

Finally, the cost study analyzed total benefit costs but did not group costs into major subcategories, such as health insurance and post-retirement benefits, as recommended by the *Cost Study Manual*. While not required in the contract, we noted that without the cost subcategory information, the Department could not identify which individual benefit elements have the most potential for future cost reduction.

Sandia National Laboratories

SNL did not perform cost studies. According to NNSA officials, the cost studies were not performed because NNSA was unable to incorporate the current version of Department Order 350.1 in its contract. One NNSA official stated that NNSA and SNL could not agree upon several issues, which made it more practical to wait for an upcoming contract re-competition. This gave SNL the option of choosing between performing a benefit value study or a cost study. As such, SNL opted to perform only benefit value studies. However, NNSA agrees that both studies are important to properly evaluate health and post-retirement benefits programs.

Contract Administration

The issues with the required contractor cost studies occurred because the Department and NNSA did not ensure that complete health and post-retirement cost studies were prepared to assist with evaluating whether contractor employee benefit costs were reasonable. Specifically, we found that the sites' Contracting Officers either did not include or did not enforce key elements of Department Order 350.1 or the associated contract clauses and Department guidance in contracts. For example, the Berkeley Site Office Contracting Officer allowed LBNL to use state and local government employees as a comparator population in its cost study because, according to the Contracting Officer, the cost study methodology was approved by the Department's Office of Management Actuary with oversight of the benefit value and cost studies. An Office of Management Actuary official told us that he approved LBNL's cost study methodology because it was the contractor's responsibility to choose the appropriate comparator population. He also stated that the recommended manufacturing employees were a good comparator population unless otherwise demonstrated. Although LBNL stated in its cost study results justification that it had initiated informal mitigating actions to improve its score, its justification did not demonstrate how its research and development employee population was a better match with state and local government employees than the Department's recommended manufacturing employee population. Despite the lack of a fully adequate justification, we noted that the Contracting Officer and the Office of Management Actuary accepted LBNL's cost study without requiring a formal corrective action plan, although the score exceeded the Department's standard of 105 percent.

In another example, the SLAC Site Office Contracting Officer stated that, due to contract changes made in 2012, the contractor assumed that reporting on the post-retirement benefit service cost was no longer required. Accordingly, when Department officials did not receive a post-retirement benefit service cost, they opted to use the cost from the prior year to complete the cost study. As previously mentioned, when we brought this issue to management's attention, they agreed that current post-retirement benefit service cost was an important component to consider when evaluating whether the contractor employee benefit cost was reasonable and committed to including it in all future costs studies.

Department and LBNL officials asserted that the cost principles contained in Federal Acquisition Regulation 31.302 and Office of Management and Budget Circular A-21 *Cost Principles of Educational Institutions* (Circular A-21) were the governing criteria and that Department Order 350.1 did not apply to contracts managed by universities. While we agree that may be the case in certain instances, we noted that the LBNL and SLAC contracts did not contain the criteria cited by management. This fact was noted in a recent Department of Energy Oak Ridge Office Financial Evaluation and Accountability Division review, which stated that although Stanford University is under Circular A-21, SLAC follows a different set of cost principles under Federal Acquisition Regulation 31.2 *Contracts with Commercial Organizations*. In addition, management stated that Department Order 350.1 contained an exemption whereby contractors offering corporate benefits to their employees were not subject to the benefit value and cost study requirements; thus, they were also not subject to the corrective action requirements. However, we found that neither contract contained that exemption. Instead, according to their contract terms, LBNL and SLAC were subject to the Department's 105 percent standard to assess whether their health and post-retirement benefits were reasonable, and they were required to submit corrective action plans or explanations when requested by the Contracting Officer.

In the case of Livermore, the Livermore Field Office's previous Contracting Officer did not ensure that LLNL's cost study met key LLNL contract clause requirements. For example, LLNL's cost study did not make a direct comparison with the Department's 105 percent standard, although LLNL officials stated they attempted to compensate by making further calculations and included the result in a cover letter attached to the cost study for NNSA. However, the current Contracting Officer agreed that to be fully compliant, the cost study itself was necessary to determine LLNL's compliance with the 105 percent standard.

In addition, the prior Contracting Officer and NNSA did not ensure that LLNL's cost study met several of the Department's *Cost Study Manual* standards. For instance, the prior Contracting Officer approved LLNL's exclusion of grandfathered post-retirement benefits service costs from the LLNL cost study because LLNL's contract did not require LLNL to compare the Department's 105 percent standard to grandfathered post-retirement benefit costs. This was due to a contract clause that guaranteed substantially equivalent benefits from a prior contract in order to retain highly trained employees at that time. However, the current Contracting Officer agreed that, although NNSA did not favor any immediate changes, a future contract change might be appropriate. In addition, NNSA officials stated that they did not promote the Department's *Cost Study Manual* standards to break costs out into appropriate categories because the LLNL contract did not require them to do so. Moreover, LLNL's cost study process was established 5 years prior to the Department issuing the *Cost Study Manual*. NNSA Officials also stated that the *Cost Study Manual* is specific to the BLS-based cost study, and the concepts therein cannot be transferred to the use of professionally-recognized studies. However, the *Cost Study Manual* guidance that we used to audit LLNL came from specific sections that address studies that are alternatives to BLS-based studies. Therefore, the standards contained in the Department's *Cost Study Manual* provide guidance to contracting officers to ensure that a consistent and accurate cost study, BLS-based or otherwise, is performed. Furthermore, according to a Department official, a cost study that meets the Department's guidance also provides a valuable baseline for future management oversight and contract decisions.

Finally, SNL had not performed cost studies because the Sandia Field Office Contracting Officer had not updated SNL's contract with the most current version of Department Order 350.1 or an NNSA standard contract clause. The Contracting Officer did not update the contract because of several issues that NNSA and SNL could not agree upon, which made it more practical to wait for an upcoming contract re-competition. At the time of this report, NNSA had begun the SNL contracting process and an NNSA official stated that a requirement for both benefit value and cost studies would be incorporated into the next SNL management and operating contract.

Benefit Value Studies

We also identified concerns with the benefit value studies. For example, two of the four contractors we reviewed had benefit value study scores that exceeded the Department's 105 percent standard. LBNL's 2012 benefit value study score was 119.5 percent and SNL's score was 107 percent. In the case of SNL, the Sandia Field Office Contracting Officer stated that SNL was under a corrective action plan that was issued in 2008, and SNL officials told us that they submitted another corrective action plan in 2014.

However, in the case of LBNL, the Contracting Officer did not request a corrective action plan, as permitted by Department Order 350.1 and LBNL's contract. Department officials explained that the Berkeley Contracting Officer exercised his authority to waive a corrective action plan because, under Circular A-21, benefit costs were considered reasonable and allowable as part of a university-based corporate plan. While we agree that these costs may be allowable, we noted that when the LBNL costs exceeded 105 percent of its comparator group costs, LBNL's contract required it to submit a corrective action plan when requested by the contracting officer. Accordingly, in our opinion, a corrective action plan should have been required to address LBNL's high 2012 benefit value score. Department officials informed us that a benefit value study completed in 2014 showed LBNL's score had decreased to 106 percent.

In addition, LLNL's benefit value study did not provide a total net benefit score weighted average that included benefits for grandfathered employees because of LLNL's contract exemption for reporting grandfathered employee benefits. The *Value Study Desk Manual* states that a single total net benefit value should be developed based on the weighted average value of current and grandfathered benefits. As mentioned earlier, by excluding post-retirement benefits for grandfathered employees, the results of cost study and benefit value analyses were not available to NNSA for nearly half of LLNL's employees.

Cost and Benefits Evaluation Impact

Because contractors had not fully completed their cost studies in accordance with Department requirements or guidance and some sites also had issues with their benefit value studies, we could not determine if contractor health and post-retirement benefit costs were cost effective and reasonable for the sites we audited. Considering the current constrained Federal budget environment and the significant amount the Department invests in contractor employee benefits ($3.3 billion in FY 2013), it is important to effectively monitor these costs which, during CY 2013, totaled about $288 million[1] in health and post-retirement benefits for contract employees at the four sites in our review.

Recent Changes to Departmental Policy

Subsequent to our fieldwork, the Secretary approved the implementation of four recommendations presented by a BenVal Task Force (Task Force). The Task Force was created to examine and evaluate the Department's use of benefit value studies. One of the Task Force's recommendations was to reiterate that studies are not required when contractors provide their employees with benefits through existing corporately-sponsored (e.g., university) benefit programs. The Task Force also recommended that contractors should update their comparator

[1] This total contains 2013 data for all sites except LBNL (which is a 2012 figure) because at the time of our fieldwork, LBNL had not yet completed its cost study using 2013 data.

groups, as needed, to ensure the most up-to-date comparisons are being conducted. The four recommendations of the Task Force are included in a proposed acquisition letter to provide guidance regarding how to use comparative benefit value studies.

RECOMMENDATIONS

To address the issues we identified, we recommend that the Head of Contracting Activity, Office of Science, improve the management of contractor health and post-retirement benefits programs by ensuring that:

1. Department guidance is followed for developing suitable benefit value and cost studies, according to the key elements of Department Order 350.1, as required by Acquisition Letter AL-2013-09 and associated contract requirements; and

2. Contracting Officers require corrective action plans, as appropriate, when the Department's benefit standards are not met.

We further recommend that the Associate Administrator for Acquisition and Project Management, National Nuclear Security Administration:

3. Disseminate guidance to Contracting Officers to ensure that key components of Department Order 350.1 requiring cost studies are incorporated into their respective contracts, and are followed.

MANAGEMENT RESPONSE

Office of Science management concurred with our report recommendations in accordance with a recent Department policy decision on the Department's use of benefit value studies. Specifically, Science stated that overall management of the benefit value and cost study requirements under LBNL and SLAC contracts was compliant with Department guidance and in accordance with their oversight role of corporate benefit programs. Science also informed us that, in accordance with the recent Task Force recommendations, they removed the contractual language requiring benefit value and cost study from four of their applicable contracts and replaced it with language that establishes corporate benefits as reasonable. Two of the four contracts affected by the modified language included LBNL and SLAC contracts.

NNSA management concurred with our recommendation and indicated that cost study requirements are already incorporated into five of the six NNSA contracts and will be incorporated into the final contract at SNL, which is being competed in FY 2016. NNSA management also stated that we did not evaluate the totality of cost management and measurement activities and that its contractors were in compliance with their contract terms. Furthermore, management cited recent improvements and how favorably its contractors performed in comparison to Department contractors in the Department's *Contractor Benefits Benchmarking and Metrics Study*.

Management's formal comments are included in Attachment 3.

AUDITOR COMMENTS

We consider Science management's comments and subsequent actions responsive to our recommendations. Science's actions to remove the benefit value study and cost study contractual requirements from the corporately-sponsored (e.g., university) benefit programs are in accordance with recent policy changes made by the Secretary. Science management also agreed to apply our recommendations to contracts with benefit programs that are not corporately sponsored.

We consider NNSA management's comments and subsequent actions responsive to our recommendation. We did note, however, that NNSA's comments included assertions that we did not evaluate the totality of cost management and measurement activities for their contractors. Conversely, our fieldwork included all substantive aspects of the NNSA contractors' health and post-retirement benefit programs in performing our audit. Although we agree that both NNSA contractors had made positive efforts to improve their programs, we could not make an accurate conclusion whether those efforts resulted in programs with reasonable costs. One NNSA contractor did not perform a cost study and the other contractor's cost study did not determine whether its costs met the contractually required 105 percent metric. As noted in the report, a process that includes a cost study and a benefit value study is the only process authorized by current NNSA standard contract clauses and Department Order 350.1 for determining the reasonableness of health and post-retirement program costs. Also contrary to NNSA's assertion, we could not base our audit conclusions on the results of the Department's *Contractor Benefits Benchmarking and Metrics Study* in the absence of compliant cost studies. Unlike the contractor-specific cost and benefit studies that use national or regional comparator populations, as appropriate, to achieve a reasonable comparison, the Department study compares health and post-retirement benefit costs among Department contractors as well as to nationwide industry benchmarks. The Department study is not required by either the contract terms or Department Order 350.1; however, it is another tool the Department uses to evaluate benefit cost trends.

Attachments

cc: Deputy Secretary
Administrator, National Nuclear Security Administration
Chief of Staff

OBJECTIVE, SCOPE, AND METHODOLOGY

OBJECTIVE

We conducted this audit to determine whether the Department of Energy was effectively overseeing contractor management of health and post-retirement benefits.

SCOPE

The audit was performed from April 2014 to August 2016, at Lawrence Livermore National Laboratory in Livermore, California; Lawrence Berkeley National Laboratory in Berkeley, California; SLAC National Accelerator Laboratory in Menlo Park, California; and Sandia National Laboratories in Albuquerque, New Mexico. We conducted this audit under Office of Inspector General Project Number A14LL039.

METHODOLOGY

To accomplish the audit objective, we:

- Reviewed Federal and Department regulations and guidance related to health and post-retirement benefits management;
- Judgmentally selected four sites for review to achieve a representative cross-section of Department sites;
- Reviewed selected sites' benefit value and cost studies for compliance with applicable regulations and guidance;
- Evaluated the results of prior audits and reviews; and
- Interviewed Department, National Nuclear Security Administration and contractor officials regarding management of contractor health and post-retirement programs.

Because a judgmental sample was used, results could not be projected to the universe. We limited our analysis to health and post-retirement benefits. The Department defines post-retirement benefits as medical, dental, vision, prescription drugs and other retiree health benefits.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those 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 objective. We believe the evidence obtained provides a reasonable basis for our conclusions based on our audit objective. Accordingly, we assessed significant internal controls and compliance with the laws and regulations necessary to satisfy the audit objective. In particular, we assessed the Department's implementation of the *GPRA Modernization Act of 2010* as it relates to our audit objective and found that the Department had established performance measures applicable to contractor health and post-retirement benefits.

Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We did not rely on computerprocessed data to achieve the objective of our audit. An exit conference was held with the Department's Office of Science management on July 12, 2016, and with NNSA management on July 13, 2016.

RELATED REPORTS

Office of Inspector General

- Audit Report on *Contractor Post-Retirement Health Benefits at the Oak Ridge Reservation* (DOE/IG-0690, May 2005). The audit found that the Department of Energy incurred costs that were considered to be unreasonable for contractor employee post-retirement health benefits at the Y-12 National Security Complex. Specifically, the Department was paying 100 percent of the employer's portion of post-retirement health benefits for Y-12 National Security Complex employees who transferred from the corporate offices of BWXT and Bechtel National regardless of how long they worked in the Department's service. The Department did not recognize corporate service in determining eligibility for post-retirement health benefits. As a result, the Department incurred costs of about $460,000 for currently retired contractor employees, and a future liability of more than $7 million for BWXT and Bechtel National employees currently working at Y-12 National Security Complex.

- Audit Report on *Follow-up Audit of Health Benefit Costs at the Department's Management and Operating Contractors* (DOE/IG-0470, May 2000). The audit found that the Department was making efforts to significantly reduce employee health benefit costs; however, the Department continued to pay substantially more than competitive market benchmarks per capita for employee health benefits. This resulted from the Department not requiring contractors to bring health benefits in line with competitive market benchmarks and industry practices. Had the Department required the contractors to bring health benefit costs in line with competitive market benchmarks and industry practices, the Department could have saved $33 million in employee health benefit costs.

- Audit Report on *Westinghouse Savannah River Company's Health Benefit Plan* (ER-B-99-03, January 1999). The audit found that a portion of health benefit costs was unnecessary and unreasonable. Specifically, Westinghouse Savannah River Company (Westinghouse) authorized Blue Cross and Blue Shield to pay additional fees for health care providers in the area of Aiken, South Carolina, that could have been obtained at preferred rates. Westinghouse agreed to pay higher rates because it did not want to inconvenience its employees and wanted to protect the Aiken Regional Medical Centers from financial difficulty. As a result, the Department would incur $1.7 million in unnecessary and unreasonable costs over a 3-year period.

Government Accountability Office

- *Department of Energy: Progress Made Overseeing the Costs of Contractor Postretirement Benefits, but Additional Actions Could Help Address Challenges* (GAO-11-378, April 2011). The audit found that the Department's existing process for having contractors align their benefit packages with the Department's reimbursement standard is incomplete. Furthermore, the Department's guidance allowed contracting officers to waive the requirement for contractors to correct benefit packages that are exceeding the Department's standard without detailing the criteria to follow in making the decision and without requiring review by Department headquarters. As a result, some contractors may continue to accrue liabilities and be reimbursed by the Department for benefit packages that exceed the Department's reimbursement standard.

- *Department of Energy: Certain Postretirement Benefits for Contractor Employees Are Unfunded and Program Oversight Could Be Improved* (GAO-04-539, April 2004). GAO found that along with unfunded balance concerns, the Department Order 350.1 studies are not performed at a significant number of contractor locations, and alternative review procedures performed by Department personnel are inconsistent from one contractor location to another; thus the Department's ability to evaluate the full range of programs is limited. In addition, GAO found that a number of comparison studies did not conform to prescribed and recommended methodologies, calling into question the validity and comparability of the results. To address this concern, GAO recommended that the Secretary of Energy extend the comparison study requirements of Department Order 350.1, to the extent practical, to all contractor locations with benefit obligations to provide better information about program-wide contractor employee benefit costs.

MANAGEMENT COMMENTS

Department of Energy
Office of Science
Washington, DC 20585

MAR 0 2 2016

MEMORANDUM FOR MICHELLE ANDERSEN
ASSISTANT INSPECTOR GENERAL
FOR INSPECTIONS
OFFICE OF INSPECTOR GENERAL

FROM: JOSEPH MCBREARTY 3/2/16
DEPUTY DIRECTOR
FOR FIELD OPERATIONS
OFFICE OF SCIENCE

SUBJECT: Response to Inspector General's Draft Report, "Management of Selected Department of Energy Contractors' Health and Post-Retirement Benefits"

Thank you for the opportunity to review and comment on the subject draft report. The Office of Science (SC) continues to contend that overall management of the Benefit Value and Cost Study requirements under the Lawrence Berkeley National Laboratory (LBNL) and SLAC National Accelerator Laboratory (SLAC) contracts was compliant with Departmental guidance and in accord with our oversight role of corporate benefit programs. We continue to assert that LBNL and SLAC manage their respective health and post-retirement benefits programs in a cost-effective manner and that this audit has not established a basis for questioning the reasonableness of their costs. We acknowledge, however, that contractual language would benefit from further clarifying the expectations applicable to our corporate contractors. SC's acceptance of the Recommendations, below, is based on our contention that we already manage our oversight in such a manner.

The report contains two recommendations for the Head of Contracting Activity for the Office of Science. The response to the recommendations is as follows:

Recommendation 1: Ensure that Department guidance is followed for developing suitable cost studies and benefits value studies, according to the key elements of Department Order 350.1, as required by Acquisition Letter AL-2013-09 and associated contract requirements.

Management Response: Concur

Action Plan: Based in part on the preliminary findings of the subject audit, SC has considered the necessity of continuing to impose the requirements of a Benefit Value and Cost Study on contractors with corporate benefits, as they are specifically excluded from

these requirements by DOE Order 350.1. Therefore contractual language requiring a Benefit Value and Cost Study has been removed from the four applicable contracts, replaced with language that establishes corporate benefits as reasonable.
In regard to contracts with non-corporate benefits no contractual changes to the model language were deemed necessary.

Estimated Completion Date: March 30, 2016

Recommendation 2: Ensure that Contracting Officers require corrective action plans, as appropriate, when the Department's benefit standards are not met.

Management Response: Concur

Action Plan: The changes as described above, under contracts with corporate benefits, eliminate the need for corrective action plans. In regard to contracts with non-corporate benefits no contractual changes to the model language were deemed necessary. Upon receipt of required Benefit Value and Cost Studies Contracting Officers will continue to utilize Departmental guidance and contractual language in assessing the necessity of a corrective action plan for those exceeding comparators by more than five percent. In addition, SC will ensure the relevant procedures contained in the Office of Science Management System (SCMS) include criteria for determining the necessity of a corrective action plan.

Estimated Completion Date: December 31, 2016.

SC does not have general and technical comments on the draft report that differ from those submitted previously.

If you have any questions on this response, please contact Margo Triassi at 202-586-3865.

Department of Energy
Under Secretary for Nuclear Security
Administrator, National Nuclear Security Administration
Washington, DC 20585

National Nuclear Security Administration

May 31, 2016

MEMORANDUM FOR RICKEY R. HASS
ACTING INSPECTOR GENERAL

FROM: FRANK G. KLOTZ F. Klotz 5/31/2016

SUBJECT: Comments on the Office of Inspector General Draft Report Titled *Management of Selected Department of Energy Contractors' Health and Post-Retirement Benefits* (2014-00988/A14LL039)

Thank you for the opportunity to review and comment on the subject draft report. We understand the Department of Energy (DOE), Office of Science, is responding separately to recommendations 1 and 2, which relate to their operations. We concur with recommendation 3, which applies to the National Nuclear Security Administration (NNSA), recognizing that the requirement to conduct a cost study is already incorporated into five of our six contracts. These requirements will be incorporated into the final contract at Sandia National Laboratories during competition in Fiscal Year 2016.

We would like to make it clear that the NNSA contractors reflected in this report are compliant with current contract requirements. Those requirements, together with other oversight activities, provide an adequate basis for evaluating the reasonableness of contractor benefit costs. As noted in the report, the auditors limited the scope of the audit to Departmental guidance for benefit value and cost study activities. This approach did not evaluate the contribution of requirements beyond that guidance, actions by NNSA to further assess the reasonableness of costs, or the actual results in managing those costs. While cost study activities are important, you must evaluate the totality of cost management and measurement activities to provide a true measure of reasonableness.

NNSA participates in the Contractor Benefits Benchmarking and Metrics Study conducted by DOE every two years. The results of this study show that overall NNSA management and operating (M&O) contractor benefit costs have continually reduced since 2010, and at a faster rate than the DOE average. Additionally, the cost of new hire benefits at NNSA sites is lower than the DOE average. Consistent with industry, NNSA contractors have closed defined benefit pension plans and have limited access to post-retirement medical benefits to legacy employees, while at the same time providing a different suite of benefits for new employees. NNSA M&O contractors continue to make changes to better align with industry.

Technical comments have been provided separately for your consideration to more accurately reflect NNSA's activities, and enhance the clarity and factual accuracy of the report. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audit Coordination and Internal Affairs, at (301) 903-1341.

FEEDBACK

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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

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