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United States Government
Department of Energy
memorandum

DATE: August 19, 1996

REPLY TO
ATTN. OF: IG-1

SUBJECT INFORMATION: Report on "Special Audit of Pension Plans for Department of Energy Contract Employees of the University of California"

TO: The Secretary

BACKGROUND:

The Office of Inspector General has issued several audit reports on the pension plans operated for Departmental contract employees, including those for the employees of the University of California operated laboratories. In general, the reports have recommended methods for improved Departmental management of the pension plans for those employees. On May 15, 1996, the Department of Energy (DOE) announced its decision to extend and renegotiate its contracts with the University of California for the management and operation of the Los Alamos, Lawrence Berkeley, and Lawrence Livermore National Laboratories. Contracts for the operation of these laboratories would have expired in 1997.

DISCUSSION:

The renegotiation process provides the Department an opportunity to recover at least $620 million in excess assets from the pension plans it has funded for University of California employees at DOE's laboratories and to improve the Department's management of those pension funds. Because the laws governing pension plans restrict an employerms ability to remove assets from pension plans, recovering the excess funds may require special legislation. As a result of this audit, we recommended that the Department set negotiation objectives to: (1) require the University of California to cooperate with the Department's efforts to recover the excess pension assets, including jointly sponsoring special legislation, if necessary; and (2) modify the pension plan arrangements to improve its ability to manage future pension benefits for the University of California employees at DOE's national laboratories.

The Office of Procurement and Assistance Management agreed in principle with the report recommendations, but declined to discuss specific elements of the Department's negotiating position with the University of California.

(SIGNED)

John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Under Secretary
Assistant Secretary for Human Resources and Administration

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

SPECIAL AUDIT OF PENSION PLANS FOR DEPARTMENT OF ENERGY CONTRACT EMPLOYEES OF THE UNIVERSITY OF CALIFORNIA

Report Number: DOE/IG-0394
Office of Audit Services
Washington, DC 20585

Date of Issue: August 1996

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

SPECIAL AUDIT OF PENSION PLANS FOR DEPARTMENT OF ENERGY CONTRACT EMPLOYEES OF THE UNIVERSITY OF CALIFORNIA

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OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES

SPECIAL AUDIT OF PENSION PLANS FOR DEPARTMENT OF ENERGY CONTRACT EMPLOYEES OF THE UNIVERSITY OF CALIFORNIA

Audit Report Number: DOE/IG-0394

INTRODUCTION

On May 15, 1996, the Department of Energy (DOE) announced its decision to extend and renegotiate its contracts with the University of California for the management and operation of the Los Alamos, Lawrence Berkeley, and Lawrence Livermore National Laboratories. Current contracts for the operation of these laboratories expire in 1997. The renegotiation process provides an opportunity for the Department to: (1) recover at least $620 million in excess assets from the pension plans it has funded for University of California employees who work at DOEms laboratories; and (2) improve the Department's ability to exercise prudent management of its interest in those pension funds.

According to Department records, as of July 1, 1995, the University of California Retirement Plan had between $620 million and $2.0 billion in excess assets that were attributable to the Department of Energy (emphasis supplied). The wide variation in excess assets is a function of the assumptions used in making these calculations. These are described in Appendix 1 to this report. We concluded as a result of the audit that, as part of the contract renegotiation process, the Department should obtain the cooperation and assistance of the University of California in recovering excess pension plan assets in a manner that does not affect the defined retirement benefits of the contract employees. This could include jointly sponsoring legislation to modify any existing legal restrictions.

BACKGROUND

Pension plans provide post retirement income for employees. The Department funds pension programs established by its management and operating contractors for the contract employees. In this case, DOE, as part of its contracts with the University of California, funded the retirement program for employees working at Los Alamos, Lawrence Livermore and Lawrence Berkeley National Laboratories. Under the terms of the current contract, the University of California has wide latitude in the management of these programs. It can, for example, unilaterally change the future pension benefits of employees at the three national laboratories.

The University of California Retirement Plan (UCRP) is a qualified governmental defined benefit pension plan that calculates benefits based on a formula that includes such factors as employee compensation and years of service. The Internal Revenue Code restricts the distribution of assets from qualified governmental pension plans. Thus, the assets and income of the UCRP cannot be used for any purpose other than to pay benefits to the employees covered under the plan unless all liabilities under the plan are satisfied. Satisfaction of plan liabilities requires that all plan participants become fully vested upon plan termination. The restrictions on distribution protect pension plan assets and the interests of plan participants. Generally, the proceeds of a plan termination and distribution are subject to a Federal excise tax. As an entity of the California state government, however, the University of California would be exempt from Federal excise taxes. As part of a larger tax bill, the Congress recently passed legislation that would allow for limited employer recovery of pension plan assets without plan termination. The Administration publicly opposed this provision on the grounds that it would lead to employer raids on pension plan assets. The tax bill was subsequently vetoed.

The Office of Inspector General (OIG) has issued five audit reports on the pension plans operated for contract employees. Those reports have identified management issues regarding the Department's funding of the pension plans for contractor employees and have recommended various measures to control pension plan costs. (See Appendix 2 for a discussion of prior audit reports.)

The OIG issued the latest audit report on pensions in 1994 and recommended that the Department require the contract operator of Sandia National Laboratory to reduce the overfunding in its pension program and return approximately $409 million in excess pension assets to the Federal Government. The Department nonconcurred with the recommendation. It took this position based on its contention that the action would require future deposits into the plan and could lead to Sandia Corporation being liable for Federal taxes; would be time-consuming, administratively difficult and cost prohibitive; and, that such action could be injurious to contractor employee morale.

OPPORTUNITY FOR RECOVERY OF PENSION PLAN ASSETS AND IMPROVED PLAN MANAGEMENT

In the May 1996 announcement of the decision to renegotiate the contracts with the University of California, the Department expressed its commitment to bring management improvements and greater accountability to its contractual relationship with the University of California. Further, the Department stated that the new contracts also must provide for enhanced oversight by the Department in business and financial management. In this context, we concluded that the current negotiations with the University of California give the Department a unique opportunity to recover excess pension fund assets from the UCRP and to modify the pension arrangement so that the DOE can exercise greater management control of its interest in the pension plans.

Current laws governing pension plans prevent employers from removing assets from a pension plan unless it terminates the plan, fully vests all plan participants, and satisfies the plan liabilities. The instant situation is complicated by the fact that the laboratories' plans are not segregated from the overall University of California pension program. About 25 percent of the assets of the UCRP are attributable to the DOE. Therefore, dissolving the pension plan in its entirety to recover any excess assets could affect thousands of University of California employees who have no relationship to the Department.

As an alternative to terminating the UCRP, special legislation could be introduced that would allow the recovery of excess pension fund assets from the UCRP. It would appear that the best opportunity to achieve the legislative consensus necessary to enact the special legislation would be if it were sponsored jointly by the Department and the University of California. This approach could also have the added benefit of allowing the University of California to recover a significant amount of excess pension fund assets contributed for non-contract employees of the University of California. To its credit, the Department's Office of Procurement and Assistance Management has already taken action to explore the feasibility of special legislation.

Need for Action. We believe that the Department should negotiate an agreement with the University of California to assist the Departmentms efforts to recover the excess pension funds and return those funds to the Department. If necessary, this should include an understanding that the University of California will cooperatively sponsor special legislation that would allow the recovery of the excess pension plan funds attributable to the DOE.

In addition, in negotiation for the new contract, the Department should establish as a firm goal the objective of obtaining a better management position over its interest in the assets of the UCRP. This should include the establishment of separate or segregated defined benefit pension plans for the laboratoriesm personnel, and the creation of a mechanism in which the Department approves material changes to the pension program for the laboratory employees, specifically including proposals that would have the effect of increasing pension liabilities.

Segregated or separate plans are required by the Departmentms policy on pension programs. In this case, the pension plans should be distinct from the main UCRP, with their own separately determined funding levels. Establishing separate pension plans for the national laboratoriesm employees would simplify accounting for the Federal Government contributions to the plan, and provide the Department more control over future changes to the pension plans. The establishment of separate pension plans would help to meet the Department's stated goal of increased accountability and provide the Department with enhanced oversight in business and financial management. The Department approached the University of California in 1995 about establishing separate pension plans for employees of the three national laboratories managed by the University. The University of California did not agree with the Departmentms proposal stating in its response that scientists at the national laboratories needed to be recognized as peers in the University of California faculty and that need included being part of the UCRP.

The University of California has made unilateral changes in the UCRP that increased benefits for participants in the UCRP. We reported in September 1992 that the University had established an additional retirement benefit for all UCRP members working during the period January 1, 1991, through June 30, 1993. The University funded the new benefit with surplus assets, reducing the Department's share of those surplus assets. General DOE policy for its management and operating contractors requires that such changes be approved by the Department before implementation. However, the unique nature of the contracts with the University of California give the University the right to make such decisions unilaterally. Given the significance of the level of excess assets currently in the UCRP, we concluded that this issue should be addressed if DOE is to be in a position to exercise appropriate management over its interest in the University's pension program. This matter is directly related to the need to establish segregated or separate pension plans for employees at the DOE laboratories managed by the University of California.

Cost Versus Benefits. The circumstances surrounding the current situation with the University of California employees are similar to those that existed during our recent audit of the Sandia pension program. When we issued a preliminary management alert related to the Sandia pension program on June 8, 1993, the Department was in the process of changing the management contractor. Based on the latest information available at the time, the Sandia pension plans were overfunded by about $589 million, of which we estimated that approximately $409 million could have been returned to the Government. Management nonconcurred in our recommendation that the Department act to recoup a significant portion of those funds. We believe that the overfunded pension position of the University of California plan (at least $620 million attributable to DOE) is so extreme that the Department needs to reexamine its earlier position.

We evaluated the Departmentms basis for its position in the Sandia matter in light of the current University of California situation. Our analysis follows:

Removing the excess funds from pension plans would create future funding deficits in the plan and would also create tax liabilities for the contractor which would lessen the amount recovered by DOE. It is our view that any transaction to remove excess funds from the University of California plan could be structured so as to leave sufficient assets in the pension plan to meet future funding needs. The specifics of this determination would require analysis by pension specialists. We were informed that the University of California would not have to pay excise taxes on the proceeds since it is a government instrumentality. If special legislation was drafted to allow the withdrawal of excess assets from all management and operating contractor pension plans, that legislation could address the issue of taxes on a global basis. Finally, even if the tax liabilities could not be avoided, any special or additional Federal taxes collected would, in effect, serve to reduce the national deficit.

The cost associated with taking action would be prohibitive. We recognize that this would be a costly undertaking. In addition to in-house experts, the Department and the University of California would likely have to obtain the services of outside specialists. However, the potential recovery associated with the University of California plan is now so large, that it is likely that the benefits would substantially exceed the costs.

The administrative steps in recovering the excess funds would be time-consuming and could not be completed before the contractor change. We recognize the complexity of this matter and the time-consuming nature of the transactions necessary to recover the excess pension plan assets. The current University of California contracts do not expire until 1997. We believe there is sufficient lead time to at least initiate the proposed recommendations and, if necessary, incorporate needed future actions in the new contract instruments.

Reducing pension fund assets would damage employee morale. We are sensitive to the concerns of the laboratoriesm employees. It is to be expected that they are concerned by any proposal that they perceive as jeopardizing their future financial security. However, the Department and the University can structure a program to minimize employee concerns. Further, the employees could be included in the process which would reassure them of the safety of their future retirement benefits.

CONCLUSION

The recovery of excess contractor pension plan assets is not unprecedented in DOE. In 1991, the Department negotiated a settlement with the E.I. du Pont de Nemours & Company and recovered approximately $610 million from the pension plan when the company terminated its management and operating contract at the Savannah River Plant after more than 38 years. The OIG had recommended that course of action to the Department as a result of the audit work on DOE/IG-0264, "Report on Pension Benefits for Du Pont Employees at the Savannah River Plant." While recovering excess funds from contractor pension plans would be administratively challenging, the potential benefits are great. Given the current state of the budget situation facing the U.S. Government, we concluded that this may be the appropriate time for aggressive action to recover these funds. Achieving this goal will require close cooperation between the Department, the contractor managing the laboratories, and laboratory personnel.

RECOMMENDATIONS

We recommend that the Assistant Secretary for Human Resources and Administration establish objectives in its negotiation with the University of California that would:

Require the University of California to cooperate with the Departmentms efforts to recover its portion of the excess pension fund assets from the UCRP, and to return those excess assets to the Department of Energy. This would include, as needed, agreeing to jointly sponsor special Federal and state legislation to ease any legal restrictions on such action.

Modify the current pension arrangement to improve the Department of Energy's ability to exercise prudent management of its interest in the pension plan established for its University of California contract employees. Specifically, the Department should be in a position to approve changes to future pension benefits for its laboratory employees.

(Signed)
Office of Inspector General

MANAGEMENT COMMENTS

The Office of Inspector General issued the final draft report on July 19, 1996, and received management comments from the Deputy Assistant Secretary for Procurement and Assistance Management on August 6, 1996.

Management Comments. Management agreed in principle with the report recommendations but declined to discuss any specific elements of the Department's negotiating position.

PENSION VALUES FOR THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN
AS OF JULY 1, 1995

DOE LABS	MARKET VALUE OF	ACTUARIAL VALUE OF	ACCUMULATED BENEFIT	PROJECTED BENEFIT

	ASSETS (1)	ASSETS (2)	OBLIGATION (3)	OBLIGATION (4)
	MARKET VALUE OF ASSETS LESS ABO	MARKET VALUE OF ASSETS LESS PBO	ACTUARIAL VALUE OF ASSETS LESS ABO	ACTUARIAL VALUE OF ASSETS LESS PBO
LBL	$706,980,000	$621,916,000	$404,011,205	$492,049,700
	$302,968,795	$214,930,300	$217,904,795	$129,866,300
LLNL	2,257,774,000	1,986,145,000	1,363,853,993	1,719,664,400
	893,920,007	538,109,600	622,291,007	266,480,600
LANL	2,124,821,000	1,869,185,000	1,325,001,609	1,645,699,300
	799,819,391	479,121,700	544,183,391	223,485,700
DOE TOTALS	5,089,575,000	4,477,246,000	3,092,866,807	3,857,413,400
	1,996,708,193	1,232,161,600	1,384,379,193	$619,832,600
UCRP TOTAL	20,129,620,000	17,707,823,000		
RATIOS DOE/UCRP	25.28%	25.28%		

(1) THE MARKET VALUE OF ASSETS REFLECTS THE MOST CURRENT MARKET PRICE FOR THE SECURITIES HELD IN THE PLAN.

(2) THE ACTUARIAL VALUE OF ASSETS REFLECTS ADJUSTMENTS TO SPREAD THE FLUCTUATIONS IN THE MARKET VALUE OF SECURITIES OVER A PERIOD OF TIME, SUCH AS 5 YEARS.

(3) ACCUMULATED BENEFIT OBLIGATIONS ARE CALCULATED ON THE ASSUMPTION THAT EMPLOYEES WILL NOT ACCRUE MORE BENEFITS UNDER THE PENSION PLAN.

(4) PROJECTED BENEFIT OBLIGATIONS ARE CALCULATED ON THE ASSUMPTION THAT EMPLOYEES WILL CONTINUE TO ACCRUE MORE BENEFITS UNDER THE PLAN.

DISCUSSION OF PRIOR OFFICE OF INSPECTOR GENERAL REPORTS ON CONTRACTOR PENSION PLANS

DOE/IG-0233, "Sandia Corporation Defined Benefit Pension Plans," (November 1986). The OIG reported that Sandia Corporation made payments into its pension plans even though the plans were overfunded by approximately $77.7 million according to the actuarial statement for the fund. The Department reimbursed Sandia for these payments.

DOE/IG-0240, "Management and Operating Contractorsm Pension

Plans," (June 1987). This DOE-wide audit, which included Sandia Corporation but not the University of California, reported that, in 1983, 20 management and operating contractors had contributed $94 million more than the minimum required funding limits to 28 pension plans. Again, these payments were reimbursed by the Department. In response to the audit, the Department issued a memorandum on interim pension funding policies in January 1988 that required field offices to limit contributions to contractor pension funds to the amount needed to maintain an equilibrium between pension fund assets and the present value of liabilities. To formalize this process, the Department began an effort to revise DOE Order 3830.1, "Policies and Procedures for Pension Programs Under Operating and Onsite Service Contracts." As of September 30, 1995, over 7 years since the interim policy was established, the revised order had not been issued.

DOE/IG-0264, "Report on Pension Benefits for Du Pont Employees at the Savannah River Plant," (February 1989). The OIG reported that the Department should assume control of the $513 million in excess assets in the Du Pont pension plan and negotiate with Du Pont a close-out of the pension plan that would provide for an independent actuarial evaluation of the Du Pont pension fund to validate the assets and liabilities; and a lump-sum settlement to provide for the pension benefits of Du Pont retirees.

DOE/IG-0314, "Pension Fund Activities at Department Laboratories Managed by the University of California," (September 1992). The OIG reported that the Department did not have sufficient internal controls to ensure that the Departmentms share of University pension funds was protected and that pension fund contributions were kept to the minimum to meet the commitment to the contract employees. At the time, the Department could not determine what portion of the $4.3 billion surplus funds in the University of California pension plan was attributable to DOE contributions. Further, under the terms of the contract with the University of California, the Department did not have the authority to approve proposed changes to University pension programs, or even the final settlement in the event of contract expiration or termination. Finally, as part of the contract, any costs associated with the University pension programs were allowable as long as they were based on the same contribution rate applied to other University elements.

As a result of the audit, the Department took steps to ascertain what portion of the pension funds were attributable to the laboratories' employees funded by the Department of Energy. Although the Department did not attempt to renegotiate contract terms that would require the Department to approve changes in laboratoriesm employee pension plans affecting the Department's share of surplus assets, it committed to reevaluating those provisions when the contract was renegotiated. In 1994, the Department tasked a consulting group with expertise in pensions to explore the possible options for recovering excess pension assets from the UCRP. That firm recommended that the Department discuss the possibility of waiving excise taxes on recovered pension benefits with the Internal Revenue Service. In January 1996, at the request of the Department, the same consulting firm revisited the issues and suggested that the Department might sponsor special legislation allowing for the removal of pension benefits from the UCRP.

DOE/IG-0346, "Audit of Sandia Corporationms Pension Plans and Other Prefunded Benefits," (April 1994). The OIG reported that the Sandia Corporation pension plan had approximately $589 million in excess assets and recommended that the Department take action to reduce the assets in Sandia Corporationms pension plans to the minimum required to cover the actuarially determined future benefits and to recover the U.S. Governmentms share of excess assets in the plans. The Department nonconcurred and stated that its position was based on the following: (1) removing the excess funds from Sandiams pension plans would create future funding deficits in the plan and would also create tax liabilities for the Sandia Corporation which would lessen the amount recovered by the DOE; (2) the cost associated with taking action would be prohibitive; (3) the administrative steps in recovering the excess funds would be time-consuming and could not be completed before the contractor change; and (4) reducing pension fund assets would damage employee morale. We were informed that the Department retained outside counsel and an actuarial firm to assist it in evaluating this matter.

AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

The objective of the audit work was to evaluate the situation facing the Department in regard to the excess assets in the UCRP and determine how the Department could recover those assets for the Federal Government. The scope of the audit effort included the possible legal issues facing the return of excess pension plan funds to the Federal Government and the amount of excess assets in the UCRP as of July 1, 1995. The audit methodology included the review and analysis of previous OIG audit reports and managementms response to those reports, DOE correspondence on pensions and, pension plan documents from the University of California.

The audit work was conducted in accordance with generally accepted government auditing standards, except that we relied upon data provided by the University of California to the Department on the amount of pension fund assets in the UCRP and did not independently verify the accuracy of this computer-processed data. Because the scope of this effort was limited, we did not perform a new assessment of internal controls over pension plans, but relied upon assessments conducted in previous audits.

IG Report No. DOE/IG-0394

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