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Office of Inspector General
Office of Audit Services

Audit Report

Contractor Post-Retirement Health Benefits at the Oak Ridge Reservation

DOE/IG-0690

May 2005



Department of Energy

Washington, DC 20585

May 20, 2005

MEMORANDUM FOR THE SECRETARY

FROM:


Gregory H. Friedman
Inspector General

SUBJECT:

INFORMATION: Audit Report on "Contractor Post-Retirement Health Benefits at the Oak Ridge Reservation"

BACKGROUND

Since 1994, the Office of Inspector General has issued a series of reports highlighting opportunities for the Department of Energy to reduce the cost of contractor employee health benefit programs while remaining competitive in the market. In 2000, we reported that the Department had not required contractors to bring health benefit plan costs in line with current market benchmarks and industry practices.

Historically, the Department's policy has been to pay for contractor employee health benefit costs, including post-retirement costs, on a "pay-as-you-go basis," with current operating funds. Thus, funds to cover future benefits are not set aside, creating an unfunded liability. The estimated unfunded liability for the Department's program to provide contractor employee post-retirement health benefits increased from \$6.4 billion in 1999 to \$8.4 billion in 2004, roughly a 30 percent increase in a five year period.

In its Fiscal Year 2003 *Assurance Memorandum*, the Oak Ridge Operations Office (Operations Office) identified inconsistencies in the requirements used to determine eligibility for contractor post-retirement health benefits. Contractor employees at the Oak Ridge Reservation facilities account for more than \$1 billion of the total Department post-retirement benefit liability. Because of the impact of eligibility requirements on the eventual total cost of benefits, we conducted the audit to determine whether the eligibility requirements for post-retirement health benefits at Oak Ridge were consistent and reasonable.

RESULTS OF AUDIT

We found that the National Nuclear Security Administration (NNSA) incurred and will continue incurring costs that we consider to be unreasonable for contractor employee post-retirement health benefits at the Y-12 National Security Complex (Y-12). Specifically, NNSA is paying 100 percent of the employer's portion of post-retirement health benefits for Y-12 employees who transferred from the corporate offices of BWXT¹ and Bechtel National regardless of how long they work in the Department's service. This is predicated, however, on having more than 10 years of corporate service.

¹ BWXT is the prime contractor responsible for operating Y-12, with Bechtel National as its major corporate partner in this engagement.



For example, NNSA is paying for the post-retirement health benefits of one BWXT corporate executive who transferred to Y-12 even though he was employed at Y-12 for only three years before taking an early retirement. This individual was eligible for the NNSA-provided health benefits because he had more than 10 years service at the corporate level.

Approximately 200 corporate employees of BWXT and Bechtel National have transferred to Y-12 since 2000. About 25 percent of these transferees had more than 10 years of corporate service and were, as a result, eligible for post-retirement health benefits paid for by the Government under the provisions described previously. We estimated that, because NNSA decided to recognize corporate service in determining eligibility for post retirement health benefits, it will:

- Incur costs of about \$460,000 for currently retired contractor employees; and,
- Accrue a future liability of more than \$7 million for BWXT/Bechtel employees currently working at Y-12.

Other NNSA sites, such as the Nevada Test Site, Sandia National Laboratories, and Pantex Plant have similar benefit eligibility clauses. Thus, NNSA's overall liability is likely to be considerable.

NNSA's approach of recognizing corporate service in determining eligibility for Government provided retirement health benefits at Y-12 was not consistent with the approach adopted by the Oak Ridge Operations Office relating to its environmental management and science contracts. Specifically, the Operations Office disallowed requests for reimbursement of similar employee benefit costs from the Bechtel Jacobs Company, which manages the environmental cleanup project at the East Tennessee Technology Park, and from UT-Battelle which operates the Oak Ridge National Laboratory.

The inconsistent treatment of costs for contractor post retirement health benefits in the Oak Ridge area resulted because the Department does not have corporate policy regarding contractor post-retirement health benefit programs. Consequently, this report includes recommendations to ensure that post-retirement benefits are based solely on work performed for Department of Energy contract efforts, and that Department officials review the reasonableness of costs incurred for corporate transferees' post-retirement health benefits under existing contracts.

MANAGEMENT REACTION

Management concurred with our finding and recommendations. Management also pointed out that the costs for post-retirement health benefits were incurred to attract corporate managers and employees who were needed to affect the cultural change sought by NNSA at the Y-12 complex.

We recognize that balancing the Government's interests with the interests of its contract employees is a challenging endeavor. From our perspective, however, it is important that this be done on a corporate basis such that any evaluation of the impact of changes to individual plans

takes into account the effect on the Department as a whole. Therefore, it has been our long held belief that the Department needs to develop a corporate strategy on contractor employee benefits aimed at addressing long-term human capital needs in a cost effective manner.

Attachment

cc: Deputy Secretary
Under Secretary for Energy, Science and Environment
Chief of Staff
Administrator, National Nuclear Security Administration
Manager, Y-12 Site Office

REPORT ON CONTRACTOR POST-RETIREMENT HEALTH BENEFITS AT THE OAK RIDGE RESERVATION

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Corporate Service Credit

Eligibility Requirements

The Department of Energy (Department), including the National Nuclear Security Administration (NNSA), was inconsistent in its reimbursement for contractor post-retirement health benefit costs. Further, as a result of these inconsistencies, contractors were reimbursed for unreasonable costs. Specifically, while NNSA reimbursed BWXT Y-12, LLC (BWXT Y-12) for the post-retirement health benefits of corporate transferees, the Oak Ridge Operations Office (Operations Office) disallowed similar costs from the Bechtel Jacobs Company, LLC (Bechtel Jacobs) contract for the East Tennessee Technology Park and denied a request from UT-Battelle, LLC (UT-Battelle), to provide similar benefits for the employees of the Oak Ridge National Laboratory.

BWXT Y-12 employees are able to use their corporate years-of-service credits when eligibility for post-retirement health benefits is determined. According to the BWXT Y-12 contract, "...employees transferring directly from a Bechtel or BWXT affiliated company will retain the continuous or credited service date recognized by the affiliated company from which they transfer for the purpose of vacation eligibility, and savings plan, pension plan, retiree medical plan vesting, and eligibility for early retirement."

With the current service credit clause, a 50-year old BWX Technologies, Inc. (BWXT Corporate) transferee with 10 years of corporate service could transfer to BWXT Y-12 and retire the next day with full post-retirement health benefits funded by the NNSA. However, an individual who has spent 9 years exclusively at the Y-12 site would not be eligible for post-retirement health benefits funded by the NNSA. Since November 2000, 192 corporate transfers have been brought onto the Y-12 site. Bechtel National, Inc. (Bechtel National) has transferred 124 employees and BWXT Corporate, 68. We found that nearly 25 percent of these employees transferred with more than 10 years of corporate service, therefore they were immediately eligible to receive post-retirement health benefits regardless of the time worked at Y-12. For example:

- One executive, who assisted in the Y-12 transition from Lockheed Martin Energy Systems, Inc. to BWXT Y-12, had transferred to Y-12 from BWXT Corporate. This individual was employed at Y-12 for about 3 years. However, since he had more than 10 years of corporate service, he was eligible for NNSA funded post-retirement health benefits the day he transferred to Y-12. He took

an early retirement and the NNSA is now responsible for post-retirement health benefits that he would not have received had he stayed with the parent company.

- Another senior executive, a BWXT Corporate career employee, retired from the Y-12 site in 2003 after 4 years of service with BWXT Y-12. Although less than 10 percent of his career was spent working at Y-12 the service credit clause requires the NNSA to pay 100 percent of the employer's portion of his post-retirement health benefits.

Bechtel Jacobs' employees who transfer from the corporate offices to the East Tennessee Technology Park cannot use their corporate service credit towards eligibility for Department funded post-retirement health benefits. In December 2002, after identifying the inconsistencies in the application of benefits, the Operations Office requested an opinion from the Department's Contractor Human Resource Management Division (Contractor Human Resources) on the reasonableness of allowing transferees to include service credits for non-Government work when determining eligibility for post-retirement medical benefits. Contractor Human Resources determined that the practice of transferring service credits and the associated liabilities was not reasonable when such liabilities are not directly attributed to services performed on Department contracts. In addition, BWXT Corporate does not offer any post-retirement medical benefits to its corporate employees and Bechtel National only provides a select group of corporate employees a small reimbursement towards the premium for post-retirement medical benefits. Therefore the costs incurred by NNSA to provide these benefits are unreasonable.

The Operations Office subsequently declared the costs associated with corporate service credits unallowable for Bechtel Jacobs and did not allow the service credit clause to be added to the UT-Battelle contract for the management of the Oak Ridge National Laboratory. In 2004, the Operations Office reported that it had ceased the practice of reimbursing post-retirement medical benefits for individuals who retire with less than 10 years of Department service. The Operations Office is now in the process of recovering the unallowable costs paid as a result of the previous method of determining eligibility for post-retirement health benefits.

Corporate Process

The variations in benefit allowability existed because neither the Department nor NNSA have established a consistent corporate process to address the reasonableness of the service credit clauses throughout the complex and to prevent their recurrence in future contracts. In addition, the determination made by the Contractor Human Resources division of the Department has not been implemented as policy complex-wide.

Officials from NNSA's Y-12 Site Office indicated that it was their intention to review BWXT Y-12's service credit clause during future contracting actions; however, they did not commit to removing the clause and believed that the benefit commitments made at contract inception should continue to be honored. Although the Operations Office agreed that the company service credit for corporate transferees could be kept, it stated the benefit should be at corporate expense and not funded by the Department or NNSA.

Cost Impacts

If the variations are not addressed, NNSA will incur about \$460,000 for 9 transferees who have already retired from BWXT Y-12 and may pay more than \$7 million for the remaining 144 transferees. Although actuarial estimates project a post-retirement medical cost of about \$2,000 per retiree per year, during 2004 the average actual medical costs were \$8,000 per retiree. Consequently, the total effect could be significantly higher. During our review, we found additional NNSA contracts with similar corporate service credit eligibility clauses. Contractors at the Nevada Test Site, Sandia National Laboratories, and the Pantex Plant allow transferees to include time served with the parent companies and affiliates when determining eligibility for post-retirement medical benefits.

RECOMMENDATIONS

We recommend that the Administrator, NNSA and the Department's Director, Office of Management, Budget and Evaluation establish and implement a consistent corporate process to ensure that eligibility for contractor post-retirement health benefits is based solely on work performed for Department contracts. We also recommend that the Administrator, NNSA direct the site offices to determine the reasonableness of costs incurred for corporate transferee post-retirement health benefits under existing contracts.

**MANAGEMENT
REACTION**

Management concurred with our recommendation to establish and implement a consistent corporate process for contractor post-retirement health benefits. Management stated that the Department established a Contractor Pension and Post Retirement Policy Council in March 2005 that would address the finding discussed in this report and ensure that inconsistencies are eliminated. Additionally, NNSA contracts will be modified at the earliest opportunity to ensure that non-Department corporate service credit for transfers does not count toward eligibility for post-retirement health benefits. All NNSA contracts will be modified by the end of Fiscal Year 2009.

Management also agreed to review the reasonableness of costs incurred for retirement health benefits provided for BWXT Y-12 employees. Management noted that allowing corporate transferees to retain their credited service date for purposes of determining benefits was a necessary incentive to attract new corporate managers and employees who were necessary to effect the cultural change sought by NNSA at the Y-12 complex.

**AUDITOR
COMMENTS**

Management's comments are responsive to our recommendations. While we recognize that Management offered credit for corporate service in determining eligibility for health benefits as an inducement to transferees in order to affect a cultural change, a final determination about the reasonableness of the resulting costs should be based on whether they are commensurate with the relative benefits that the Government actually obtained in achieving its objectives.

Appendix 1

OBJECTIVE The objective of the audit was to determine whether the eligibility requirements for post-retirement medical benefits at the Reservation were consistent and reasonable.

SCOPE We performed the audit from October 2004 through May 2005 at Department Headquarters in Washington, DC; and the Oak Ridge Operations Office, Y-12 Site Office, and Y-12 National Security Complex in Oak Ridge, Tennessee. The scope of the audit included the Department's post-retirement health benefits at the Department and NNSA.

METHODOLOGY To accomplish the audit objective, we:

- Met with Headquarters procurement and benefits personnel;
- Discussed benefits with Oak Ridge Contractor Human Resources;
- Calculated estimated post-retirement health benefit liabilities;
- Analyzed Oak Ridge Reservation prime contracts and modifications;
- Reviewed required Federal Accounting Standards submissions;
- Evaluated procurement controls at the Oak Ridge Reservation; and,
- Reviewed applicable Federal regulations, Departmental Orders, and implemented procedures and practices.

We conducted the audit according to generally accepted Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. 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 computer-processed data to accomplish our audit objective.

Appendix 1 (continued)

Finally, we assessed the Department's compliance with the Government Performance and Results Act of 1993. The Department did not establish specific performance measures related to contractor post-retirement medical benefits.

Management waived the exit conference.

PRIOR AUDIT REPORTS

- *Follow-up Audit of Health Benefit Costs at the Department's Management and Operating Contractors* (DOE/IG-0470, May 2000) The Department's actions in response to the prior audit have significantly reduced employee health benefit costs. Several contractors implemented actions that substantially reduced overall costs while maintaining competitive benefit programs for employees. However, despite these improvements, the Department continued to pay substantially more than competitive market benchmarks per capita for employee health benefits in CY 1998. This occurred because the Department did not require contractors to bring health benefit plan costs in line with competitive market benchmarks and industry practices. Had the Department required the three contractors we examined to bring health benefit plan costs in line with competitive market benchmarks and industry practices, the Department could have saved \$33 million in employee health benefit costs in CY 1998.
- *Westinghouse Savannah River Company's Health Benefit Plan* (ER-B-99-03, February 1999) This review found that a portion of Westinghouse Savannah River Company's (Westinghouse) 1997 and 1998 health benefit costs were unnecessary and unreasonable. Westinghouse instructed Blue Cross Blue Shield of South Carolina (BC/BS) to pay health care providers in the Aiken area at higher rates than BC/BS paid its other preferred providers in South Carolina. The condition existed because Westinghouse did not want its employees to be inconvenienced and it wanted to protect the Aiken Regional Medical Centers from financial difficulty.
- *Audit of Health Benefit Costs at the Department's Management and Operating Contractors* (DOE/IG-0350, June 1994) We found that the Department's policies and procedures did not ensure that M&O contractors paid their fair share of health benefit costs. We audited \$95 million in health benefit costs paid to six M&O contractors and determined that \$15.4 million of these costs were excessive when compared to those of other firms as established by a national survey.
- *Department of Energy: Certain Postretirement Benefits for Contractor Employees Are Unfunded and Program Oversight Could Be Improved* (GAO-04-539, April 2004) As of September 30, 2003, the Department reported an estimated \$13.4 billion in unfunded contractor postretirement health and pension benefits. The approval and monitoring of Department contractor employee pension and postretirement health benefits is primarily the responsibility of Department contracting officers, who administer contracts at individual contractor locations. Management does not systematically review information developed at individual contractor locations to identify best practices or areas where benefit comparisons do not adhere to agency requirements or guidance. Developing and disseminating this information agency-wide would enhance the Department's oversight of contractor employee benefit costs.



Department of Energy
National Nuclear Security Administration
Washington, DC 20585



MAY 17 2005

MEMORANDUM FOR George W. Collard
Assistant Inspector General
for Audit Operations

FROM: Michael C. Kane 
Associate Administrator
for Management and Administration

SUBJECT: Consolidated Departmental Comments to IG's Draft
Report on Y-12's Post Retirement Health Benefits

The National Nuclear Security Administration (NNSA) has prepared, and coordinated with the Office of Management, Budget and Evaluation/Chief Financial Officer (OMBE/CFO), a consolidated response to the Inspector General's (IG) draft report, "Contractor Post Retirement Health Benefits at the Y-12 National Nuclear Security Complex." We understand that the IG conducted this audit to determine whether the eligibility requirements for post-retirement health benefits at the Oak Ridge Reservation were consistent and reasonable.

According to the draft report, we understand that the IG is concluding that the Department is inconsistent in the methodology and philosophy it employed to determine the allowability of contractor post-retirement health benefit costs. We further understand that the IG believes that the costs that NNSA reimbursed the contractor for post-retirement health benefits to be expenses that are unreasonable.

Collectively we agree that there was an inconsistency in how DOE policy related to the entire contractor post-retirement health benefit issue was implemented in this instance. This was not due to any failure to address this issue on a corporate basis, but, rather, this was due to the special provision in the Personnel Appendix to the subject contract that allowed for prior employment with the corporate office to count for credits under the NNSA funded post retirement health benefit plan. As the report notes, the Oak Ridge Operations Office successfully questioned similar costs in several earlier contracts. This was because the corporate review process established in DOE Order 350.1, Contractor Human Resour Management Programs, and the applicable FAR criteria for determining the reasonableness, allowability, and allocability criteria of such costs to the contracts were applied consistently to those contracts.

Additionally, the Department Secretary established, on March 1, 2005, a Contractor Pension and Post Retirement Policy Council to serve as the corporate policy and decision making body on precedential policy actions or proposed actions with significant financial consequence to the Department. The Council is the corporate authority to formulate new policies, processes, and procedures affecting post retirement health benefits. As an action generated by this report, the CFO, as Co-Chair of the Council, will take into consideration the findings and recommendations raised in the report, balanced against the existing DOE Order 350.1 review process and the applicable procurement regulations, and will ensure any inconsistencies are eliminated.

NNSA's previous response to the IG disagreed that the costs associated with post-retirement health benefits for BWXT Y-12 were unreasonable. Collectively, we agree that the cost should be questioned not on the basis of the "reasonableness" of the cost but on the basis of the "allocability" of the cost to Government contracts. This is because the use of prior years of service at a corporate office, subsidiary, and other affiliated companies in determining eligibility for post retirement benefits including retiree health benefits is an established industry practice. It is more appropriate and highly defensible to question the "relative benefits received" or the "equitable relationship" between the post retirement health benefit cost of corporate transferees and the DOE/NNSA contracts.

In this particular case as cited in the report, when BWXT Y-12 was awarded their current contract, NNSA expressly stated that a cultural change needed to be effected at the Y-12 complex. This cultural change could only be accomplished with significant changes in management and the induction of new corporate ideas. At the time it was viewed as prudent to allow corporate transferees to retain their continuous or credited service date for purposes of determining benefits, including post-retirement health benefits, as an incentive to attract new corporate managers and employees necessary to effect such a cultural change. NNSA does agree that it would be imprudent to be caught in a worst case scenario (which has not occurred) as described in the draft report. Therefore, NNSA will establish processes—with the advise and guidance of the Council—that will no longer allow corporate service for transfers to count toward eligibility for post-retirement health benefits under an NNSA contract. NNSA contracts will be modified at the earliest appropriate opportunity to ensure that non-M&O corporate service for transfers does not count toward eligibility for post-retirement health benefits under a M&O contract. All NNSA contracts should be appropriately modified by the end of Fiscal Year 2009. NNSA does reserve the management prerogative, as do all appropriate senior departmental managers, to create exceptions, where necessary, to effect cultural change as noted above. Additionally, NNSA will adhere to applicable Codes and Regulations that allow for transition of employees into and out of NNSA contracts.

The report further had a recommendation related to the determination of reasonableness of costs incurred for corporate transferee post-retirement health benefits under existing contracts. As stated above, this is an issue of allocability.

cc: Administrator
Chief Financial Officer
Manager, Oak Ridge Operations Office
Manager, Y-12 Site Office
Director, Service Center

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