Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

FY2007 EFAST2 Development Costs

September 29, 2006

2006-12/PA-0026

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Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

September 29, 2006

MEMORANDUM AUDIT REPORT

TO: Vince Snowbarger
Interim Director

FROM: Robert Emmons
Inspector General

SUBJECT: FY2007 EFAST2 Development Costs (2006-12/PA-0026)

INTRODUCTION

In October 2005, I sent a memorandum to the former Executive Director, Pension Benefit Guaranty Corporation (PBGC) that expressed concern about a proposal to increase PBGC's budget by $7 million ($7M) to fund the ERISA Filing Acceptance System (EFAST2).[1] Specifically, the Department of Labor (DOL) directed PBGC to include $7M in its FY2007 budget request to fund a share of EFAST2 development costs. I also expressed some legal and accounting concerns.

DOL's Employee Benefits Security Administration (EBSA) is developing EFAST2 with two partnering agencies, the Internal Revenue Service (IRS) and PBGC. PBGC's budget request includes $7M of the $14.5M development costs. IRS is a significant user of EFAST information (the current system), but they are not funding any of the EFAST2 development costs. My office initiated this audit to follow-up on my memorandum and to determine if PBGC's funding for EFAST2 is disproportionate.

RESULTS IN BRIEF

We concluded that PBGC's share of EFAST2 development costs for FY2007 is not proportionate to the percentage that DOL and IRS, the partnering agencies, are paying for current EFAST operational costs. This $7M budget request results in PBGC paying 48% of the EFAST2 development costs while PBGC's share of the EFAST operational costs are about 2%. We were concerned that policy makers (Congress, the PBGC Board of Directors, and in particular the Department of Treasury) were not fully aware of this issue.

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[1] A copy of the Inspector General's October 2005 memorandum is in Appendix II.

Paying a disproportionate amount of EFAST2 development costs raises legal and accounting concerns that subject PBGC, IRS and DOL to public scrutiny. If Congress approves this budget request, it sets a precedent for using PBGC trust funds, which are to be used for retirees and PBGC activities and operations, to supplement the appropriations of other Federal agencies.

PBGC's General Counsel concluded in November 2005, that if PBGC is to pay a disproportionate share of development costs, Congressional approval would be needed. DOL officials reached the same conclusions. DOL officials also worked with a House Appropriations sub-committee to include specific language in PBGC's FY2007 appropriation to authorize the $7M payment.

We confirmed that Congressional appropriations and oversight committees and PBGC's Board of Directors were not fully informed of the issues we raised, including the risks of disproportionate funding. We are issuing this report to fully disclose our findings and conclusions to decision-makers before Congress approves PBGC's FY2007 budget request.

We believe there are inherent risks associated with using PBGC trust funds to supplement another agency's budget request. This action establishes a precedent of using trust funds to cover budget shortfalls. Furthermore, this action runs the risk of generating negative publicity for PBGC because it would be supplementing another Federal agency's budget at the same time PBGC itself is running a deficit.

We are not questioning the merits of EFAST2 or its planned implementation. We recognize the benefit of an improved, fully-electronic system. However, PBGC should not be forced to use trust funds to pay a disproportionate share of the development costs.

Therefore, we recommended that PBGC:

- Inform the Board of Directors of the disproportionate funding and supplementation issues in this report;
- Request DOL to reconsider using PBGC funds to pay a disproportionate share of EFAST2 development costs; and
- Notify Congressional appropriations and oversight committees of the budget supplementation issue and the disproportionate cost-sharing arrangement being proposed.

Agency Comments

We provided the draft report to PBGC for comment. PBGC agreed with our findings and recommendations. In addition, because the issue of disproportionate payment impacted DOL and IRS, we gave them the opportunity to comment on our draft report. Based on the IRS comments, we changed the report to include language to clarify that DOL changed its strategy for funding EFAST2 development without consulting with PBGC or IRS about cost-sharing or obtaining an agreement to share costs. DOL disagreed with our conclusion that EFAST2 funding was disproportionate. They also suggested our report was questioning Congress' authority to appropriate $7M of PBGC trust funds for EFAST2 development. After reviewing the DOL comments, we continue to believe the proposed funding for EFAST2 is disproportionate, and that providing information to Congress did not constrict the appropriations process. The Congressional appropriation for PBGC was not passed before our final report was issued, and informing Congress of our conclusions was consistent with OIG's responsibilities under the IG Act.

A summary of Agency comments and our evaluation begins on page 8, and verbatim comments are included in appendices to this report. Because DOL, the Board of Directors and Congressional appropriations and oversight committees have been fully informed of the issues in this report, we consider our recommendations closed.

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BACKGROUND

DOL created EFAST in partnership with IRS and PBGC to process the Form 5500 for pension plan sponsors. Form 5500 filings represent the financial position of employee benefit plans, and are required filings for thousands of pension, health, and welfare benefit plans. In 2000, the agencies began to process Form 5500s using EFAST. The EFAST system currently accepts filings generated using any of three different formats: 1) government printed forms, 2) computer generated paper forms identical in format to the printed forms, and 3) computer generated forms using a bar code which may be filed on paper or electronically. Only the computer generated form may be filed electronically.

EFAST2 will be a new system for filing the Form 5500s electronically. When fully implemented, DOL said the new system will provide comprehensive data on employee benefits and will support the President's plan to ensure the transparency of retirement information for workers, investors, and retirees. In addition, the new system will help DOL and other federal agencies effectively target enforcement efforts and strengthen compliance.

DOL paid the entire developmental cost for the EFAST system, and further planned to fund the entire development cost for the EFAST2 system. However, due to budget shortfalls, DOL changed the EFAST2 funding strategy, without consulting with the partnering agencies. The new strategy was to share the development costs with the IRS and PBGC based on their operational cost allocation of the EFAST system. In August 2005, IRS discovered that DOL planned to assess PBGC $500,000, IRS $7M, and DOL $7M. By the time DOL requested IRS to include $7M in the IRS' budget request, IRS officials said it was too late in their budget planning cycle. When the cost-sharing proposal was not possible, this left a budget shortfall for EFAST2 development. Thereafter, in October 2005, in consultation with OMB, DOL directed PBGC to include $7M for EFAST2 development in PBGC's budget request for FY2007, against the objections of PBGC's management. This direction came as a passback from OMB. PBGC requested an appeal on the passback decision to DOL, however, DOL did not include it in its appeal to OMB.

DOL also drafted "earmark" language for PBGC's appropriation to make this action legal, i.e., requiring PBGC to transfer $7M to EBSA to pay for EFAST2 development.[2] Thus far, the House Appropriation's Committee reported out the appropriations bill, stating that "language is also included to require that the PBGC share in the costs of the new EFAST2 System being developed by EBSA" and to transfer $7M to EBSA.[3] DOL officials said they briefed the House Appropriations sub-committee on the issue. However, we confirmed the House and Senate Appropriations committee staff were not fully informed of the issues.

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[2] See H.R.5647, Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Bill, 2007.

[3] See 109-515, Report of the Committee on Appropriations [To accompany H.R. 5647], Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Bill, 2007 (June 20, 2006).

Our audit focused solely on the proposed funding for EFAST2. We are not questioning the merits of the new system or its planned implementation. We recognize the benefits of an improved, fully-electronic filing system for Form 5500s. However, PBGC should not fund a disproportionate share of EFAST2's development costs.

DISPROPORTIONATE FUNDING

PBGC's share of development costs for EFAST2 is disproportional based on the partnering agencies' historical allocation of EFAST operating costs, the existing system that EFAST2 will replace. If PBGC is required to pay $7M, it will pay about 48 percent of the EFAST2 development costs. Yet, its share of EFAST operational costs has been, and is projected to be, only about 2.1 percent. This occurred because of DOL budget shortfalls, changing the funding strategy, and late notification to the IRS regarding the development funding need. Table 1 compares the allocation of development costs and the projected operational costs based on EFAST use.

Table 1: Development Cost and Projected EFAST2 Use

Government Agency	Development Cost EFAST	EFAST2 $14.5M*	Projected EFAST2 Operational Costs[4]
Department of Labor, EBSA	100%	52% ($7.5M)	42.2%
Pension Benefit Guaranty Corporation	0%	48% ($7M)	2.1%
Internal Revenue Service	0%	0%	54.6%
Social Security Administration**	0%	0%	1.1%

* Estimated
** SSA will not be a partner in EFAST2

The Government Accountability Office (GAO) criticized DOL in 1991 for disproportionate funding of IT project costs, and concluded that disproportionate funding violated 31 U.S.C. sections 1301 and 1532.[5] GAO noted that DOL's methodology for assessing costs among its agencies resulted in some DOL agencies bearing costs for things that benefited other agencies, while other DOL agencies were not assessed their fair share of project costs. We believe the facts of this proposed funding decision are similar to the 1991 case. When

[4] In a December 2005 report titled *EFAST Budget Estimate and Agency Cost Allocation,* DOL's contractor, Mathematica Policy Research, Inc, developed a cost allocation/sharing algorithm based on actual EFAST use. This was to be applied to EFAST2 costs and consequently was referred to in the FY2007 EFAST2 E300s.

[5] See *Matter of: Use of Agencies' Appropriations to Purchase Computer Hardware for Department of Labor's Executive Computer Network*, 70 Comp. Gen 592, June 28, 1991.

agencies undertake the pooling of expenses to achieve a commonly sought goal, their respective contributions must be proportionate to their interest in the product, in this case EFAST2.

In November 2005, PBGC's General Counsel responded to the OIG's October 2005 memorandum, stating that she had raised legal concerns about the legality of this proposal to DOL officials. The General Counsel understood that DOL Solicitor's Office was advising DOL officials on the appropriate legal mechanisms for obtaining the necessary funding, including the possibility of seeking specific authorizing language from Congressional appropriators. We met with officials from DOL Solicitor's Office to discuss this issue. Their legal research on the subject of disproportionate funding concluded that if PBGC is being charged a disproportionate share, DOL must seek Congressional approval, the same conclusion reached by PBGC's General Counsel and the OIG.

DOL officials worked with a House Appropriations sub-committee in drafting language in PBGC's FY2007 appropriations bill that would authorize PBGC to transfer $7M in trust funds to DOL to pay for EFAST2 development costs. We were concerned that the appropriators did not have complete information when they inserted the $7M earmark in PBGC's appropriations. We briefed the House and Senate Appropriations committee staff on the disproportionate nature of this transaction and that PBGC opposed this action.

In commenting on a preliminary draft of this report, DOL said that the annual operating cost is not the only way to measure PBGC's use of the EFAST data. For example, they stated that in one recent year, PBGC requested roughly 10 million pages of data out of a total of about 25 million pages collected, or approximately 40 percent of the available data. This statement raises several questions:

- Were these 10 million pages used exclusively by PBGC and not by any of the other participating agencies?
- For what purpose did PBGC request the 10 million pages, i.e., were these pages essential for PBGC to administer its pension insurance program, or requested because the data had been collected and could be used for analysis?

After examining additional information DOL provided, we continue to believe PBGC is being assessed a disproportionate share of EFAST2 development costs because:

- In the September 19, 2005 E-300 submitted to OMB,[6] DOL assessed $500,000 to PBGC for EFAST2 development costs, which is close to the 2.1 percent historical operating costs that PBGC paid for EFAST. DOL did not propose any new cost sharing measurement. This audit is based on the documents created at the time the

[6] The E-300 is an OMB budget justification document used by agency management and OMB to review and assess major information technology investments before they are included in the President's Budget Request to Congress.

$7M was added to PBGC's budget request, not "value" assertions developed in response to our audit.

- IRS has no money allocated in its FY2007 budget for EFAST2 development costs yet it is a significant user: DOL's contractor for EFAST2 projects the IRS share will be about 55 percent.[7]
- Any new bases for sharing in development costs should be fully disclosed to IRS and PBGC so the partnering agencies can verify the proportional use attributed to their organizations and the allocated costs.

USING TRUST FUNDS TO SUPPLEMENT APPROPRIATED FUNDS

DOL's initial proposal for funding EFAST2 was for DOL to pay the total development of the EFAST2 system. DOL's second proposal was for DOL to pay, $7M, IRS to pay $7M, and PBGC to pay $500,000. Based on interviews and documents produced, we found IRS could not include $7M in its FY2007 budget because of budget reduction pressures and the request came "too late" in the IRS budget cycle. In October 2005, PBGC officials were instructed by DOL to increase PBGC's FY2007 budget request by $7M. At that time, PBGC officials alerted DOL to the possible risks and legal concerns involved with this decision. Contemporaneous with DOL's actions to add $7M to PBGC's budget, the DOL Solicitor's Office researched the issues PBGC raised. DOL Solicitor's Office concluded that if PBGC is being charged a disproportionate share, DOL must seek congressional approval. The Solicitor's Office also commented that PBGC did not appear to have the authority to use its access to the trust funds to subsidize DOL or IRS ERISA activities.[8]

Using a disproportionate amount of PBGC's trust funds for EFAST2 development costs might appear to inappropriately supplement DOL's appropriated funds. DOL was to pay the development costs for EFAST2 but when DOL realized they would be unable to fund the entire amount, they sought funding from the partnering agencies. None of the partnering agencies were prepared to add the fiscal requirement in their FY2007 budgets. However, because the PBGC budget is processed through DOL, DOL was able to instruct PBGC to put the $7M for EFAST2 development in its budget.

If EFAST2 development costs are to be shared, then they should be shared by all users. The IRS is the largest user of EFAST and projected to remain the largest user of EFAST2. If PBGC pays $7M of the $14.5M development costs it will appear that trust funds are being used to supplement appropriations. Such an allocation is inconsistent with PBGC's

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[7] We note that this use percentage is likely to increase based upon the new enforcement responsibilities given to the Department of Treasury in the recently passed pension reform legislation.

[8] Ultimately, in the passback from OMB, PBGC's overall budget was cut by $5.195M, and then increased by $7M specifically to fund EFAST2. PBGC sent a letter to DOL to appeal this proposed funding decision, however, it was not included in any appeal to OMB.

trustee responsibility "to protect the interests of plan participants and beneficiaries" (29 U.S.C. § 1342(d)(1)(B)(viii)).

LEGAL AND ACCOUNTING ISSUES

PBGC's disproportionate share of development costs also raises legal and accounting concerns that subject PBGC, IRS, and DOL to public scrutiny. Since its inception, neither OMB nor DOL has ever designated funds from PBGC's budget to subsidize other agencies' programs. Thus, this action could set an unwarranted precedent. Also, a potential conflict of interest may be perceived because of DOL's dual rule of oversight authority for the EBSA's and PBGC's budgets, and the Secretary of Labor's position as Chair of PBGC's Board of Directors. The funds transferred from PBGC will be used to fund the DOL program responsible for developing EFAST2.

Using a disproportionate share of PBGC funds for development costs raises financial accounting concerns. Because EFAST2 is not owned or operated by PBGC, it is unclear how the agency will record the developmental costs on its books. Both the Federal Accounting Standards Advisory Board and Financial Accounting Standards Board require internal software be capitalized. At this point there is no way to know how much, if any, of the $14.5M meets the criteria for capitalization. Finally, the disproportionate use of PBGC funds appears to be inconsistent with the Economy Act, which governs transfers of funds between federal agencies and among agency components.

RECOMMENDATIONS FOR THE INTERIM DIRECTOR, PBGC

1. Inform the Board of Directors of the disproportionate funding and augmentation issues in this report;
2. Request DOL to reconsider using PBGC funds to pay a disproportionate share of EFAST2 development costs;
3. Notify Congressional appropriations and oversight committees of the budget augmentation issue and the disproportionate cost-sharing arrangement being proposed.

PBGC COMMENTS and OIG EVALUATION

In response to the report's recommendations, the PBGC Interim Director stated that he sent an email to the Board representatives calling their attention to the report that had been transmitted to them by the OIG. The Interim Director noted that PBGC had raised the issue of disproportional funding with the Deputy Secretary of Labor on October 18, 2005, and requested that DOL reconsider the issue of disproportional funding throughout the budget process. DOL declined to change their original decision. Because disproportionate funding was considered a budgetary issue, PBGC believes all available avenues were exhausted to resolve the issues raised by OIG, and it was inappropriate to raise the issue directly with Congress.

OIG considers PBGC's actions responsive to the intent of our recommendations because it is clear that they have used available avenues to raise the issue of disproportionate funding to the Board and DOL through the budgetary process. PBGC's verbatim response is at Appendix III. Because DOL, the Board of Directors and Congressional appropriations and oversight committees have been fully informed of the issues in this report, we consider our recommendations closed.

OTHER AGENCY COMMENTS and OIG EVALUATION

Because the issue of disproportional funding impacted two other agencies, we discussed preliminary drafts of this report with responsible officials at DOL, provided a final draft of the report to both DOL and IRS, and gave them the opportunity to submit formal responses to our draft report. Verbatim replies from DOL and IRS are at Appendix IV and V.

<u>The Internal Revenue Service</u>

The IRS said it was important to note that DOL changed its strategy for funding EFAST2 development costs without consultation with the partnering agencies about cost-sharing arrangements or obtaining an agreement to cost-share. It was always IRS' understanding that DOL was to pay EFAST2 development costs. Consequently, IRS said it never sought an appropriation to fund any of the development cost of EFAST2. Late in FY 2005, DOL sought to convert EFAST2 to a shared development project between IRS, DOL and PBGC. However, IRS said it was too late in the year for IRS to include it in the FY2007 budget request. We note that this response is consistent with information IRS staff provided during the audit. In addition to its response, IRS provided specific suggested language to clarify what occurred during the planning and development process for EFAST2. In response to the IRS comments, we incorporated their suggestions as appropriate.

<u>The Department of Labor</u>

In its response, DOL disagreed with our conclusion that PBGC will be funding a disproportionate share of EFAST2 development costs. In support of their disagreement, DOL stated that we made two assertions:

- "PBGC utilizes fewer unique questions on Form 5500," and
- "PBGC uses only 2.1% of the data that would be collected through the new EFAST2 system" (page 2 of the DOL response).

We did not make these assertions in our report. We did cite 2.1% in our report, which is the percentage of historical operating costs allocated to PBGC. This is not an "OIG estimate," as DOL stated, but was computed by a DOL contractor in a December 2005 report titled "EFAST Budget Estimate and Agency Cost Allocation," as the basis of allocating operating costs for EFAST. In fact, the $500,000 originally allocated to PBGC for its share of the $14.5M EFAST2 development costs is close to the 2.1% historical operating cost amount (2.9%).

DOL asserts that PBGC benefits disproportionately from the current EFAST system and cost sharing should be based on overall usefulness of the pension data provided. DOL suggests that PBGC should have an equal share of development cost based on its use of 12.5 million pages out of a total of 19.5 million pages, or 64% of the available data.

Stating that PBGC uses 64% of the available data is misleading for several reasons: (1) PBGC is provided more data than it requests or needs (to avoid additional costs of specific EFAST queries), and (2) it does not consider the data use of the other partnering agencies. In August 2006, DOL provided OIG with the following breakdown of "pages used" by PBGC, IRS, DOL, and the Social Security Administration (SSA):

Agency	Pages Provided to Agency (in millions)	Percent
DOL	17.7	36%
IRS	17.7	36%
PBGC	12.5	25%
SSA	1.3	3%

We note that this cost-sharing methodology using page counts has never been presented to either PBGC or IRS for review and verification. This information was only presented to OIG in response to our preliminary draft report in August 2006. In addition, the page count methodology is not statistically based and has changed several times. Since August 2006, DOL has given us three different sets of page counts numbers that ranged in allocating PBGC's EFAST2 development cost from 25 to 64 percent. More importantly, DOL did not use this methodology as the basis for inserting $7M in PBGC's FY2007 budget.

Moreover, the DOL response does not recognize the most important issue with regard to proportional funding – if development costs are to be shared by partnering agencies, *all* of the participating agencies should pay a proportional share, and *all* of the parties should agree on an equitable methodology for allocating development costs. DOL has suggested several ways to allocate development costs, but none of these methods allocate development costs to IRS - a major partner for EFAST2. After analyzing the data provided by DOL, including historical operating costs, information submitted to the Office of Management and Budget during the budget process in the E300, and the information provided by DOL during the course of the audit and in its response to this report, we continue to conclude that DOL did not adequately support allocating $7 million of EFAST2 development costs to PBGC.

DOL also suggests that by concluding the funding for EFAST2 was disproportionate, the OIG is constraining, and improperly directing, Congress regarding "what constitutes an appropriate use of PBGC funds. It states that the House and Senate Appropriations bills have already provided $7 million as the PBGC's share of the EFAST2 project. DOL also expressed concern that OIG provided an unfinished draft report to Congress and used it to lobby the Congressional staff to consider changing the current appropriations language.

The Inspector General has a statutory duty to directly report to Congress and PBGC's Board of Directors significant PBGC issues. Because Congress was considering PBGC's appropriation, we are obligated to keep Congress and the Board fully informed of major issues concerning that appropriation. We initially reported our concerns with disproportionate funding in October 2005, and our concerns were known to DOL. Our report is not intended to dictate to Congress PBGC's appropriation but rather to provide transparency to the appropriations process. As we state on page 2 of our report: "We are issuing this report to fully disclose the findings and conclusions to decision-makers before Congress approves PBGC's FY2007 budget request." We believe it is important to inform the Board and Congress of the inherent risks of PBGC paying a disproportional share of EFAST2 development costs before they take action.

We continue to believe that this action would establish a precedent of using trust funds to cover appropriated budget shortfalls. To avoid confusion by using the technical budget term "augmentation," we have clarified this section and use the term "supplement." Finally, we note, as of the date of our report, specific language authorizing PBGC to pay $7 million for EFAST2 was included in the House appropriations for PBGC, but similar language was not included by the Senate.

Appendix I

Objectives, Scope, Methodology and Abbreviations

Objectives, Scope and Methodology

In 2005, during the FY2007 budget formulation process, DOL increased PBGC's budget request for EFAST2 from $500,000 to $7M. The EFAST2 development cost is expected to be approximately $14M. DOL, IRS and PBGC are partnering agencies for EFAST2. Only DOL and PBGC will fund the EFAST2 development cost. The objectives of this review was to verify the EFAST2 development cost for FY2007, then determine how these costs were allocated among the partnering agencies. Finally, we will examine whether the $7M development cost DOL allocated PBGC to pay is proportionate.

The scope of our review covered DOL, IRS, and PBGC's Fiscal Years (FY) 2005 to 2007 budgeted expenditures for EFAST and EFAST2. From June to August 2006 we met with key EFAST and EFAST2 program and budget officials from the partnering agencies. We examined emails and support documents pertaining to PBGC, DOL, IRS and OMB related to EFAST and EFAST2 covering FYs 2006 and 2007. Our review was conducted from January to August 2006, in accordance with government auditing standards.

We obtained background information about EFAST and EFAST2, reviewed memoranda issued by PBGC officials and OIG, obtained data request and conducted interviews with program and budget officials at DOL, IRS and PBGC to:

- Understand the history of EFAST.
- Identify the partnering agency's use of EFAST and EFAST2.
- Identify the EFAST2 cost.
- Determine how EFAST2 development costs were allocated among the partnering agencies.

We examined PBGC's budget and the process, partnering agencies EFAST2 budget expenditures and cost sharing arrangements, governing Federal and PBGC laws, regulations, and policy regarding PBGC trust fund money and spending prohibitions or limitations, and GAO reports. We attempted to discuss this issue with OMB but their officials opted not to meet with us.

We did not examine the merits of the EFAST2 system and therefore, offer no comments on it other than to report that DOL sought public comments on the new system and received favorable feedback.

A copy of this report can be obtained from our website: http://oig.pbgc.gov or by contacting Jacqueline M. Wilson at (202) 326-4000, extension 3439.

Objectives, Scope, Methodology and Abbreviations

Abbreviations

DOL	Department of Labor
EBSA	Employee Benefits Security Administration
EFAST	ERISA Filing Acceptance System
EFAST2	Proposed Replacement System for EFAST
ERISA	Employee Retirement Income Security Act of 1974, as amended
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation

Appendix II

Inspector General's October 2005 Memorandum

Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

October 28, 2005

To: Bradley D. Belt
Executive Director

From: Robert Emmons
Inspector General

Robert Emmons 10/28/05

Subject: Funding for E-FAST2

I recently became aware of a proposal to increase PBGC's budget by $7.5 million to fund E-FAST2 development costs in FY2007. Based on an informal inquiry, I have serious concerns with the proposal because PBGC trust funds would be used to pay for a disproportionate share of project costs.

As I understand the budget proposal, PBGC's budget proposal would be increased from $500,000 to $8,000,000 for E-FAST2. This would increase PBGC's proportional share of project costs from less than 4 percent to more than 50 percent for FY2007. This appears to be disproportionate, considering that PBGC uses less than 3 percent of Form 5500 filings each year.

The Government Accountability Office criticized the Department of Labor in 1991 for disproportionate funding of project costs, and concluded that disproportionate funding violated 31 U.S.C. sections 1301 and 1532. Based on my initial review, the facts in the current E-FAST2 proposal are similar to the 1991 case. I also have concerns about compliance with the Economy Act.

Considering the legal issues and potential adverse publicity to PBGC that could result from improper use of trust funds, I recommend a legal review of the proposed funding of E-FAST2. If increased funding is included in PBGC's budget, I recommend that PBGC's budget submission fully disclose the disproportionate funding level to Congress.

I would appreciate a response that indicates the actions you plan to take in response to my recommendations. I would also welcome the opportunity to discuss any concerns you have.

cc: Gordon S. Heddell, Inspector General, Department of Labor

Comments from the Pension Benefit Guaranty Corporation

PBGC
Protecting America's Pensions
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

September 15, 2006

Robert L. Emmons
Inspector General
Pension Benefit Guaranty Corporation
1200 K Street, NW
Washington, DC 20005

Re: Management Comments on Draft Report "FY2007 EFAST2 Development Costs"

Dear Mr. Emmons:

Management appreciates the opportunity to comment on the draft report prepared by your office concerning the costs assessed to the Pension Benefit Guaranty Corporation (PBGC) for the ERISA Filing Acceptance System (EFAST2) currently being developed by the Department of Labor (DOL).

In October, 2005, the Chief Administrative Officer sent a memo to the Executive Director raising the issues of disproportionate funding and use of trust funds as opposed to appropriated funds. A copy of that memo was faxed to Deputy Secretary Steven Law at DOL on October 18, 2005. Subsequently, DOL worked with the Office of Management and Budget (OMB) and the House Appropriations Committee staff to add language to the FY2007 appropriations language for PBGC that provided for payment of the additional amount.

Each year, Congress authorizes administrative spending for PBGC. That authorization is contained in the appropriations bill covering the Departments of Labor, Education and Health and Human Services. More specifically, PBGC's budget is contained within the provisions for the Department of Labor. Historically, PBGC presents its proposed budget to DOL and the Office of Management and Budget. It then becomes a part of the President's budget sent to Congress for the particular fiscal year. Virtually all communications with the appropriations committees have been handled by DOL and OMB. On rare occasions, PBGC has discussed issues unique to PBGC's funding and mission directly with appropriations staff with DOL's knowledge.

PBGC management pursued the issues raised by the OIG through the avenues it felt were available to it, namely the established budget process. Further, management felt it would have been inappropriate to work outside the established

Comments from the Pension Benefit Guaranty Corporation

Robert L. Emmons
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processes by going directly to Congress. With the assistance of OMB, DOL did take this issue to Congress and obtained language it felt was sufficient to overcome the concerns then raised by PBGC and now by the OIG. It would have been inappropriate for PBGC to question the extent of the information given by DOL to the appropriations staff when it asked for language providing for the payment by PBGC for EFAST2.

Note that the issues that were raised by PBGC were those of disproportionate funding and the use of trust funds in that manner. It did not raise the corollary question of augmentation of another agency's budget. As a result, PBGC treated this matter as part of the normal budgetary process and did not feel it was necessary to share it with the full Board.

The report recommends that PBGC inform its Board of Directors of the issues raised. It is our understanding that a copy of your report was sent to the Board representatives by your office. In addition, I sent an email to the Board representatives and their representatives calling the report to their attention.

The second recommendation was that PBGC management request DOL to reverse its decision. As explained above, PBGC had pursued these issues through the normal budget process. However, in light of the expected report, I informally asked that the decision be reconsidered. As the letter sent by Deputy Secretary Steven Law to your office indicates, DOL feels they followed the appropriate processes and that there is no reason for a change in their original decision.

Finally, the report recommends that PBGC notify Congressional committees of these issues. As set out above, PBGC feels that it pursued these issues through the appropriate channels in its initial handling of the proposed allotment of costs. Once a budget decision becomes part of the President's budget, the decision-making process within the executive branch is complete and it would have been inappropriate to challenge it by going directly to Congress. It is my understanding that you intend to discuss this matter with appropriate Congressional officials.

PBGC appreciates the attention that the Inspector General's office has given to these issues. While management agrees that the issues raised are relevant, we feel we used the processes available to us to appropriately address these concerns.

Sincerely,

Vince Snowbarger

Vince Snowbarger
Interim Director

Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SEP 18 2006

Mr. Robert Emmons
Inspector General
Pension Benefit Guaranty Corporation
1200 K Street, N.W.
Washington, D.C. 20005-4026

Dear Mr. Emmons:

Thank you for the opportunity to review the draft report on the FY 2007 EFAST2 Development Costs (your Memorandum dated August 25, 2006, *Draft Report on FY 2007 EFAST2 Development Costs (2006-12/PA-0026)*). As it is currently drafted this report contains some statements that I believe will leave its readers with an inaccurate understanding of the decision making process for the EFAST2 system. These inaccuracies touch on some fundamental issues: who was expected to pay for the system's developmental costs; what changed about this expectation; and, when did this change occur.

First, at all relevant times it was IRS' understanding that DOL was to pay the development costs for the EFAST2 system. This is, as your draft report notes, consistent with the funding of the development costs of the predecessor system, EFAST. It is also consistent with the E300s developed for submission to OMB for funding in FY 2005 and FY 2006. I would note that consideration was given, throughout the EFAST2 planning process, to using IRS' "Modernization E-File System" instead of using a third-party vendor. This alternative approach was never adopted. Instead, IRS, DOL and PBGC agreed to use a third party vendor with the development costs to be paid by DOL. Based on this understanding and the consistent past practice of all three agencies, IRS never sought an appropriation to fund any of the development costs of EFAST2.

Later, DOL sought to change the responsibility to pay for the development costs of EFAST2 and to effectively convert EFAST2 to a shared development project. In seeking this change DOL never formally requested IRS to fund the development costs of EFAST2. DOL did, on June 30, 2005, informally mention that such a request might be made at some future date. At that time IRS noted that it was already too late for such a request to even be considered as part of the IRS FY 2007 budget. IRS heard nothing more about DOL's decision to take a shared development approach to this project until August, 2005, when DOL sent IRS a copy of the FY 2007 E300 that it was submitting to OMB. The IRS, at that time, again told DOL that the Service could not agree to fund the EFAST2 development costs. DOL made no further request of the IRS with respect to the EFAST2 development costs. Based on these facts, I believe it is

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inaccurate to conclude, as the draft report does, that the use of PBGC trust funds would augment the IRS budget, since the IRS never had any budget responsibility for the development costs of EFAST2.

I cannot speak to the policy question about whether the PBGC trust fund is being appropriately used in this case. What I can say is that the tenor of your report suggests that the IRS somehow acted improperly or was complicit in inappropriate actions. We were not and your report should not suggest otherwise. Therefore, I ask that you make changes to your final report so that it accurately represents the agencies' actions throughout the EFAST2 planning and development process. I am forwarding specific suggestions to correct the report under a separate cover.

If you have comments or would like to discuss this matter further, please contact me.

Sincerely,

Steven T. Miller

Comments from the Department of Labor

U.S. DEPARTMENT OF LABOR

OFFICE OF THE DEPUTY SECRETARY
WASHINGTON, D.C.
20210

September 15, 2006

Mr. Robert Emmons
Inspector General
Pension Benefits Guaranty Corporation
Washington, DC 20005-4026

Dear Mr. Emmons:

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) audit report concerning the development costs for the EFAST2 financial data modernization project.

First, I appreciate the strong support that you and your office have expressed for the EFAST2 project. As you note in your report, "[w]e recognize the benefit of an improved, fully-electronic system." Your report also lists a number of reasons for the development of the EFAST2 system; paramount among them is the need to "ensure the transparency of retirement information for workers, investors, and retirees." In fact, as we have discussed, **the EFAST2 modernization project will improve the timeliness, accuracy and reliability of information provided to the Pension Benefit Guaranty Corporation (PBGC)**, the Employee Benefits Security Administration (EBSA), and – most importantly – the workers and retirees who depend on these agencies for the assurance of their retirement benefits.

As we know, whenever a large, underfunded pension plan fails, it impacts not only the balance sheet of the PBGC, but also – and just as significantly – the lives and economic well-being of thousands of older workers and retirees. Because of that concern, in the last few years **the PBGC has sought to aggressively invest in acquiring more accurate and timely financial information on pension plans.** For example, in a May 2005 reapportionment request, the PBGC recommended an investment of $8,891,500 to establish a new "risk management" operation, consisting largely of high-end financial analysis contracts.

Since that proposal did not have a fully-conceived business case, the PBGC was provided $500,000 through the May 2005 reapportionment to develop such an analysis. **At the PBGC's request, the Department then included in its FY 2007 budget submission a request for $4,641,000 for a "Risk Management, Early Warning System and Legal Matter Management System."** Again, much of the investment proposed for "risk management [and] early warning" was aimed at

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improving the quality of financial data at the PBGC's disposal, and consisted largely of high-end consultancies. The President's FY 2007 Budget also includes $2,534,000 for PBGC to spend for this purpose.

PBGC's Share of EFAST2 Development Costs Not "Disproportionate"

Given the PBGC's consistent interest in developing better financial information sources to aid its evaluation of pension termination and takeover risk exposures, your audit report's conclusions about PBGC's level of investment in the EFAST2 project are highly perplexing. Your report asserts that the PBGC's share of the development costs of EFAST2 is "disproportionate" because the PBGC utilizes fewer unique questions on Form 5500, on a percentage basis, than its assigned share of the costs. But the EFAST2 project is not about adding or subtracting information; it is about improving the quality and timeliness – and therefore the *overall usefulness* – of the pension financial data provided to EBSA and PBGC via the Form 5500.

Not only does the PBGC have an *equal interest* in improving the financial data that helps protect older workers' and retirees' pension savings, its *actual use of this data* far exceeds the strained analysis used in your report. Contrary to the OIG's assertion that the PBGC uses only 2.1% of the data that would be collected through the new EFAST2 system, a careful analysis of the 2003 Form 5500 filings reveals that the PBGC requested approximately *12.5 million* pages – out of a total of 19.5 million pages – collected by the current EFAST system. That represents a **usage rate of 64%** of the available data – despite the fact that the PBGC has not contributed anything to the development or ongoing maintenance of the current EFAST system. That some of this data was also used by EBSA and the Internal Revenue Service for their programmatic purposes does not change the fact that **the PBGC benefits disproportionately from the existing EFAST system, and its use of the EFAST2 system is likely to greatly exceed the 2.1% estimate cited by your report.**

The reason the OIG's estimate is off the mark is that it calculates PBGC's share of the cost on the basis of whether it has primary interpretive jurisdiction over the content of a specific question on the Form 5500. The OIG's allocation method significantly understates PBGC's actual data usage, both in absolute terms and in comparison to EBSA and the IRS. In practice, all three agencies share common usage of the majority of questions on the Form, regardless of which agency has primary interpretive jurisdiction. As the EFAST2 E300 demonstrates, PBGC is projected to use EFAST2 data for such purposes as matching premiums against payments, calculation of claims for bankruptcy and other significant corporate events, claims forecasting, and litigation preparation.

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In fact, the Form 5500 remains the primary source of pension financial data on which PBGC relies, notwithstanding its efforts to develop additional, expensive data sources by investing trust fund assets in "risk management" and "early warning" capabilities. Roughly 31,000 defined benefit plans file Form 5500s, which are available to the PBGC for review. In contrast, PBGC receives Form 4010s from only about 1,000 defined benefit plans (a number likely to decrease under recently passed pension reform legislation). Both such quantitative data and qualitative analysis make it very clear that the EFAST2 system is essential to PBGC's responsibilities on behalf of older workers and retirees. Premium payers into the trust fund will also be users of EFAST2. All plan sponsors paying PBGC insurance premiums file Form 5500s. Thus, the modest investment of trust fund assets for EFAST2 matches the cost of the new system to end users who benefit from the PBGC's insurance program.

PBGC OIG Constricts Congress's Authority Regarding EFAST2 Funding

Although we strongly disagree with the OIG's contention that the PBGC's share of EFAST2 development costs is disproportionate, we do agree in principle with the PBGC's General Counsel that, "*if* PBGC is being charged a disproportionate share of development cost, congressional approval would be needed."

However, we are concerned that the tone, purpose and specific findings of this audit report all convey the OIG's evident view that it would be improper for *Congress* to decide to appropriate funds for the EFAST2 system in a way that the OIG deemed to be "disproportionate." For example, the OIG complains that, "while the House Appropriations Bill does have language that would authorize PBGC to transfer funds to DOL for EFAST2, it does not disclose that by doing so PBGC will be paying a disproportionate share." Moreover, the OIG asserts that "[i]f Congress approves this budget request, it sets a precedent for using PBGC trust funds, which are to be used for retirees and PBGC activities and operations, to augment the appropriations of other federal agencies." Lastly, the OIG states, "We believe there are inherent risks associated with PBGC augmenting IRS' budget request and this action will establish a bad precedence [sic] of using trust funds to cover budget shortfalls."

Not only do these statements indicate a misunderstanding of the concept of budget augmentation, they also presume that the PBGC OIG – not Congress – has the last word on what constitutes an appropriate use of PBGC funds. If, as your report admits, "the House Appropriations Bill does have language that would authorize PBGC to transfer funds to DOL for EFAST2," it is not the place

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of any entity in the Executive Branch to dictate to Congress what further disclosures must accompany that appropriations action.

Disproportionality and augmentation are very serious matters – as they pertain to actions by an *agency* to use *previously appropriated funds* in a manner not authorized by Congress. However, the PBGC OIG audit report advances the novel argument that *Congress itself* is constrained by the PBGC OIG's unilateral determinations about disproportionality and augmentation. As noted above, the report states that "[i]f Congress approves this budget request, it [i.e., Congress] sets a precedent for using PBGC funds…to augment the appropriations of other federal agencies." As you know, the FY 2007 Labor-HHS Appropriations bills reported by both the House and Senate Appropriations Committees provide $7 million as the PBGC's share of the EFAST2 project. Plainly stated, under Article I of the Constitution, Congress has the authority to appropriate as it sees fit. Thus, even if the PBGC's share of development costs for EFAST2 *were* disproportionate, there can be no budget augmentation and no violation of 31 U.S.C. Sections 1301, 1532, or the Economy Act as the Draft Report also incorrectly suggests.

The report also relies on a June 28, 1991 decision by the Comptroller General, <u>Use of Agencies' Appropriations to Purchase Computer Hardware for Department of Labor's Executive Computer Network</u>, 70 Comp. Gen. 592, B-238,024, 1991 WL 135552. However, this decision is easily distinguishable from the current matter. The 1991 GAO decision ruled on whether funds *previously appropriated* to specific agencies within the Department of Labor could be reallocated *administratively* to pay for computer equipment without congressional authorization. By contrast, the EFAST2 funding request was submitted to Congress as part of the President's FY 2007 Budget. No funds whatsoever have been administratively allocated; and at this stage, the Appropriations Committees of both Houses of Congress have approved this provision of PBGC funds.

<u>Conclusion</u>

Regarding the specific recommendations made in your audit report, I note that all three of them – informing the Members of the PBGC Board of your concerns, informing Congress of your concerns, and seeking reconsideration of the funding request – have already been unilaterally implemented by the PBGC OIG through your circulation of the draft report and direct consultations with congressional staff.

Since it was our understanding – based on discussions with your office – that the Department would be able to submit comments to the draft report prior to its issuance as a *final* report (on or around September 15), we were surprised to

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learn that the unfinished draft report already had been circulated to Congress, and that it was being used to lobby congressional staff to consider changing the current appropriations language with respect to EFAST2. By comparison, we are not aware of any release of a draft report, prior to inclusion of the appropriate responding party's comments, by the Department of Labor's Inspector General over the past five and a half years.

Lastly, while we disagree on the appropriate funding level that the PBGC should bear for the EFAST2 project, I deeply appreciate your concern for the integrity of the PBGC's trust funds, and your conviction (which this Administration shares) that we must make every effort to protect the retirement savings of both PBGC participants and all American workers.

Sincerely,

Steven J. Law

cc: Vincent Snowbarger, Acting Executive Director, PBGC
Judith Starr, General Counsel, PBGC

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