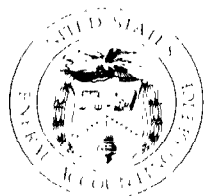


November 1991

FINANCIAL AUDIT

System and Control
Problems Further
Weaken the Pension
Benefit Guaranty Fund



**Comptroller General
of the United States**

B-164292

November 13, 1991

**To the President of the Senate and the
Speaker of the House of Representatives**

This report presents the results of our attempt to audit the Pension Benefit Guaranty Corporation's fiscal year 1990 financial statements in accordance with our authority under the Government Corporation Control Act (31 U.S.C. 9101-9110). The Corporation provides guarantee protection for the pensions of nearly 40 million Americans in more than 95,000 ongoing private sector, defined-benefit pension plans. As of the end of fiscal year 1990, the Corporation had assumed responsibility for paying basic benefits to approximately 346,000 participants on some 1,600 terminated plans. The report describes serious financial system deficiencies and internal control weaknesses that prevented us from completing the audit and that impair the Corporation's ability to carry out its mission. It also provides a discussion and analysis of the Corporation's reported financial condition.

Results in Brief

Serious financial system deficiencies and internal control weaknesses prevent the Corporation from preparing reliable financial statements. These conditions also seriously affect the Congress' ability to assess whether the Corporation's premium levels are adequate to meet its long-term obligation to pay timely and uninterrupted benefits on terminated plans. The system deficiencies and control weaknesses identified involve the Corporation's process of estimating its liability for future benefits, its processing and follow-up of premium filing data, and its accounting operations. The Corporation agreed with our assessment and it has initiated efforts to address these deficiencies and weaknesses. However, its success will depend largely on management's commitment to implementing the necessary improvements effectively.

The Corporation's reported financial condition as of September 30, 1990, while unaudited, indicates that it faces an uncertain financial future. While the Corporation still has sufficient assets to meet its near-term benefit payment obligations, it reported an operating loss of \$780 million for fiscal year 1990, increasing its accumulated deficit to \$1.8 billion. This deficit exists because the Corporation, over its 16-year existence, has not received sufficient income from premiums and invested assets to finance its losses and other operating expenses. In

keeping with the self-financing nature of the guarantee program, sponsors of ongoing pension plans will be expected to fund the accumulated deficit in addition to financing the future cost of the guarantee program.

During economic downturns like the one now being experienced, the combination of declining investment values and an increased potential for losses from terminations of underfunded plans places the Corporation's financial condition at increased risk. Economic downturns tend to increase the risk posed by underfunded plans in distressed industries such as steel, automobiles, and airlines. While losses from economic downturns are not sufficiently probable to be recognized in the financial statements now, the Corporation's financial future will largely depend on the economic well-being of these industries.

Since our first attempt to audit the Corporation (for fiscal year 1977), weaknesses in internal controls and financial systems have prevented us from expressing an opinion on its financial statements. The serious and continuing nature of these weaknesses demonstrates an ineffective management commitment, in the past, to establishing and maintaining internal controls and financial systems. The Corporation's long-standing weaknesses, its accumulated deficit, and its possible future losses for underfunded ongoing pension plans led us and the Office of Management and Budget to include the Corporation on our respective lists of "high risk" agencies and programs.

Background

The Pension Benefit Guaranty Corporation guarantees payment of most private sector defined benefit pension plans. These plans provide a specified monthly benefit at retirement, usually based on salary and years of service. Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1301 et seq., created the Corporation as a wholly owned government corporation established to protect the basic pension benefits of qualified private sector defined benefit plans that terminate without sufficient assets to pay promised benefits. Under ERISA, the Corporation has three principal missions:

- (1) to encourage the continuation and maintenance of voluntary private sector defined benefit pension plans for the benefit of their participants,
- (2) to provide timely and uninterrupted payment of guaranteed pension benefits, and

(3) to maintain premiums at the lowest level necessary to carry out the Corporation's obligations.

As established by legislation, the guarantee program operates much like mutual insurance. Policyholders (that is, American businesses with qualified defined benefit pension plans) support the cost of the guarantee program through premiums while retaining the primary responsibility for providing retirement security for their workers and retirees. In turn, the Corporation is responsible for encouraging sponsors to continue their plans and for protecting the basic retirement benefits of workers whose sponsors are unable to do so. Consistent with the self-financing nature of the guarantee program, operations are financed by (1) premiums that are set by the Congress and funded by sponsors of qualified defined benefit plans, (2) plan assets acquired when an underfunded pension plan terminates, (3) recoveries from sponsors of terminated underfunded plans, and (4) income earned on invested assets.

The Corporation is required to report annually to the President and the Congress on its business operations. This report must include the financial statements which set forth the Corporation's finances, the results of its operations, and an actuarial evaluation of the expected operations and status of Corporation funds. The Corporation is governed by a Board of Directors consisting of the Secretaries of Labor, Commerce, and the Treasury. The Executive Director oversees the Corporation's daily activities.

We have reported the results of our attempt to audit the Corporation's financial statements on four previous occasions. In each case, we have cited fundamental weaknesses with various aspects of the Corporation's liability estimation, premium income, and accounting operations. These weaknesses prevented us from expressing an opinion on the Corporation's financial statements because of their serious nature and the significance of the accounts involved.

Objective, Scope, and Methodology

Our objective was to conduct a financial audit of the Corporation's fiscal year 1990 financial statements as a basis for expressing an opinion of whether the statements were fairly presented. Because of the serious financial system deficiencies and internal control weaknesses we identified, we concluded that the statements were unauditably. We therefore limited our work to documenting the identified deficiencies and weaknesses and reporting the results of our work. Our work was performed

at the Pension Benefit Guaranty Corporation in Washington, D.C., primarily between March 1990 and January 1991. Appendix I provides additional background on our objective, scope, and methodology.

Our audit work was performed in accordance with generally accepted government auditing standards. The Corporation provided written comments on a draft of this report. These comments are discussed and evaluated in the "Agency Comments and Our Evaluation" section of this letter. Our report on the Corporation's fiscal year 1990 financial statements (GAO/AFMD-91-48) is included as appendix II. The Corporation's unaudited financial statements are included in appendix III.

System and Control Weaknesses Hinder an Accurate Assessment of the Corporation's Financial Condition

Serious weaknesses in financial systems and internal controls prevent the Corporation from preparing reliable financial statements which present accurately its financial condition. Reliable and accurate financial statements are essential to evaluating whether the Corporation's premium levels are adequate to meet its long-term obligation to pay future benefits on terminated plans. These weaknesses involve basic operating functions—liability estimation, premium processing, and accounting.

Sound financial management depends on strong financial systems that contain sufficient discipline, effective internal controls, and reliable financial information. Effective internal controls provide management with reasonable, but not absolute, assurance that (1) obligations and costs are in compliance with applicable laws, (2) assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) transactions are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports.

Control Weaknesses Limit Reliance on Liability Estimates

Because of weaknesses in controls over the Corporation's estimation process, including a lack of supporting documentation and missing data, we could not evaluate the reliability of the Corporation's reported \$4.8 billion estimated liability for future benefits. The liability for future benefits makes up 95 percent of total liabilities. Since it is only partially offset by \$3 billion of assets, the liability is also primarily responsible for the Corporation's accumulated deficit of \$1.8 billion.

Each year, as of the balance sheet date, the Corporation must estimate its liability for future benefits on its terminated plans as well as on those plans which the Corporation expects will terminate in the future. The

Corporation has developed three estimating techniques for plans at different stages in the termination process. Each technique is intended to estimate, as of the balance sheet date, the liability for future benefits using available data. Because of the nature of the underlying data used with each technique, the three techniques produce estimates with varying degrees of precision. However, even with the constraints of available data, each technique is expected to produce accurate estimates.

For plans which have terminated and for which the Corporation has obtained and updated the data needed to determine final benefit levels, the Corporation calculates its future benefit liability for each individual covered by the plan. To determine final benefits, the Corporation must obtain, update, and evaluate data on individual participants, the plan, and its sponsor in order to determine each participant's pension benefit in accordance with the Corporation's statutory requirements. This process often takes 3 to 5 years after plan termination to complete.¹ Once all the pertinent data have been obtained and entered into the automated data base, the Corporation uses specially designed valuation software, the Individual Participant Valuation (IPV) system, to calculate the present value of each participant's future benefits as of the balance sheet date. This estimating technique is considered the Corporation's most precise estimating technique because it uses current participant data to develop an individual value of future benefit liability. As of September 30, 1990, about 21 percent of the Corporation's reported liabilities for future benefits was estimated using the IPV system.

For plans that have not reached the stage in processing to permit use of the IPV system, the Corporation has developed two alternative estimating techniques. These techniques are less precise because, to varying degrees, they rely on noncurrent data to develop plan-level estimates rather than current data to develop an estimated future benefit liability for each participant.

- The first alternative technique is generally used on plans for which the Corporation has obtained and evaluated the required data needed to determine the final benefit for each individual but has not yet entered the benefit payment and other pertinent data into the automated data base, which must occur prior to the Corporation's use of the IPV system. This technique takes a plan-level liability measured as of the date a plan

¹In the interim, for those participants eligible for current benefit payments, the Corporation makes estimated benefit payments.

actually terminated, and ages—or brings forward— this estimate to the balance sheet date. This aging often covers a period of more than 3 to 5 years. As of September 30, 1990, about 29 percent of the Corporation's reported liabilities for future benefits was estimated using this technique.

- The least precise technique is used on the Corporation's remaining two types of plans: (1) terminated plans for which the Corporation has not completed the data gathering and evaluation work needed to determine final benefits and (2) plans that the Corporation expects will terminate as underfunded plans in the future. This technique relies on plan-level liability data developed by the administrator and actuaries of the ongoing plan. The Corporation uses this pretermination, plan-level data to develop a plan-level estimated liability as of the date of termination or projected termination date. Then, for those plans that actually have terminated, the technique ages, or brings forward, this estimated liability at termination to the Corporation's balance sheet date. The Corporation does not age the estimated liability to the balance sheet for those plans expected to terminate in the future. As of September 30, 1990, about 50 percent of the Corporation's reported liabilities for future benefits was estimated using this technique.

Each estimating technique consists of a unique combination of mathematical formulas and assumptions, which, when applied to the applicable data, are intended to yield an actuarially based estimate of future benefit liability. To evaluate the reliability of each technique, it is necessary to (1) understand the interaction of formulas, (2) assess the quality of the applicable data, (3) evaluate the appropriateness and application of assumptions, and (4) compare how well the estimates produced by each technique approximate an individual participant valuation. However, we were unable to evaluate the reliability of the Corporation's estimates for the following reasons:

- The Corporation did not maintain current documentation and support for each technique's formulas and assumptions, which prevented us from understanding the interaction of the formulas and evaluating the appropriateness of assumptions used.
- Weaknesses in IPV system software and participant data—such as (1) the IPV system inability to value certain benefits, (2) out-of-date IPV system documentation, and (3) missing participant data used in the Corporation's most precise estimating technique—prevented us from evaluating the appropriateness of the alternative estimating techniques.
- A comparison of estimates produced by different techniques for a non-random sample of plans identified unexplained differences in estimates,

which prevented us from evaluating the relative estimating capabilities of the various techniques.

As a result, we could not evaluate whether (1) each technique produced estimates that reasonably approximated the results that would be obtained if an individual participant valuation were performed, (2) assumptions were consistently applied and individually represented the best estimate of the Corporation's anticipated experience, and (3) data, in all material respects, were the most accurate and complete information reasonably available.

System Weaknesses Rendered the Premium Processing System Inoperative

From August 1988 through fiscal year 1990, the Corporation could neither effectively pursue unpaid premiums, interest, and penalties nor reliably account for earned premium income because it did not process premium-related information filed by plan administrators. This occurred because the Corporation's Premium Processing System (PPS), which also serves as its subsidiary accounting system for reporting and controlling premium-related transactions and assets, had not been successfully modified in time to accommodate a statutory change in the Corporation's premium structure effective in 1988. The change imposed a variable rate premium based on the degree to which a plan's liability for future benefits was not adequately funded by plan assets. The Corporation stopped using its PPS and stored the data until the program change could be made. The warehousing of reported premium data continued for approximately 2 years—August 1988 to September 1990.

Administrators of qualifying private-sector defined benefit pension plans annually determine plan premiums by calculating a fixed rate premium on the number of covered participants and, if applicable, a variable rate premium (subject to a dollar-value limit) based on the level of plan underfunding. To support their calculation, plan administrators report various premium-related information in accordance with Corporation guidance.

The Corporation developed its PPS to (1) maintain and process premium filing information reported by plan administrators from the more than 95,000 qualified plans the Corporation protects and (2) control premium-related information. Without an operating system, the Corporation was unable to perform basic premium processing, collection, accounting, and enforcement functions. For example, it could not

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- post and store premium-related transactions and data to appropriate plan history files;
 - process and edit premium-related data to check for accuracy and completeness;
 - identify and flag unusual and incorrect transactions and data warranting follow-up action;
 - account for, control, and report premium-related accounting information; and
 - generate refund, premium, interest, and penalty due notices.

According to Corporation officials, after the close of fiscal year 1990, the Corporation began limited processing of the stored data as well as the new premium filing data received after September 1990. This limited processing included (1) posting premium-related information to plan history files, (2) processing refunds, and (3) preparing past-due filing notices for issuance to potential nonfilers. However, Corporation officials do not expect to complete other key processing functions on premium filing data received since August 1988 until some time in fiscal year 1992. These include (1) cleaning up premium data posted to PPS, (2) editing the completeness and accuracy of the variable rate premium and supporting information, and (3) generating automated billing documents for amounts owed for premiums, interest, and penalties. The Corporation faces a substantial task in attempting to complete the processing of all stored premium filing information, in resolving the processing problems that can be expected to arise, and in generating billing documents.

In addition to the processing function, the Corporation has been unable to effectively carry out many of its enforcement duties, such as promptly notifying appropriate officials when premium filings and payments are late. Also, without a functioning subsidiary accounting system for premiums, the Corporation has been forced to estimate its earned premium income and premium receivables in its financial statements for fiscal year 1990. These estimates were developed because actual accounting data, which would have been produced if premium transactions had been processed promptly and accurately in a subsidiary accounting system, were not available.

The inoperative PPS system also limited the Corporation's ability to use newly available plan funding data in assessing its potential loss exposure from ongoing underfunded plans. As part of this assessment, the Corporation has historically relied on various outside data sources, including plan funding data reported to the Securities and Exchange

Commission (SEC) and Internal Revenue Service (IRS), to identify firms with underfunded plans. The Corporation has relied on outside data sources because, prior to the implementation of the variable rate premium during fiscal year 1988, plan administrators were not required to report plan underfunding to the Corporation. However, because the data are prepared to meet SEC and IRS reporting requirements, they contain gaps and/or weaknesses that limit the Corporation's ability to promptly identify underfunded plans.

With the implementation of the variable rate premium, the Corporation began receiving the type of plan funding data needed to effectively identify underfunded plans for further review and analysis. Had the Corporation processed the reported plan funding data it received, it would have had the most complete and useful data base available to begin assessing its potential future loss exposure from underfunded plans. However, without this useful data base, the Corporation was forced to continue its reliance on less complete and less useful data from external sources.

Inoperative Accounting Controls Weaken Asset Safeguards and Limit the Reliability of Financial Information

Essential system and internal control features of the Corporation's accounting operations did not function during fiscal year 1990. In January 1986, the Corporation decided to stop using its existing general ledger accounting systems while pursuing the acquisition of a new integrated financial management system. As a result of this decision, there was no operating general ledger system for the Corporation's trust accounting through the first 6 months of fiscal year 1990, nor were there accounting procedures to govern and control the processing of all accounting information throughout the year. While Corporation officials expect to be able to process most accounting transactions in an accurate and prompt manner by fiscal year 1992, the lack of documented accounting procedures and delays in full system implementation will continue to place Corporation assets at risk and to seriously jeopardize the credibility of its reported financial information.

The effective and continuous operation of both a general ledger system and related accounting procedures is essential to ensuring that processed accounting information is reliable. The impact of accounting transactions, regardless of the source, should be promptly recognized in the general ledger. The general ledger represents the highest level summary of accounting information and should be supported by subsidiary ledgers that contain lower levels of accounting detail. By providing a means of monitoring summary balances for items such as obligations,

accounts payable, and accounts receivable, the general ledger represents an essential internal control over financial activities. Properly designed and applied accounting procedures should ensure that accounting information is accurately and consistently processed by the general ledger system in accordance with management's policies.

Historically, the Corporation has accounted for its revolving fund and trust fund financial activity in separate general ledger systems. The revolving fund activity includes the Corporation's premium receipts and subsequent disbursement of these funds to pay operating expenses and the portion of current benefit payments funded by revolving funds. The trust fund activity encompasses the Corporation's accounting for trustee assets acquired from terminated plans, the related liability for future benefits, and the portion of current benefit payments funded by trustee assets. The current weaknesses in accounting controls we identified began with the Corporation's 1986 decision to abandon its two existing general ledger systems even though the replacement system with its accompanying general ledgers was not ready.

As an interim measure, the Corporation began accounting on a manual "ad hoc" basis until it began operating the Financial Accounting and Reporting Systems (FARS) in fiscal year 1990. During this period, "ad hoc" accounting was performed largely without current operating procedures and without the system and procedural controls associated with an operating system. This condition resulted in inconsistent accounting and created confusion among accounting personnel. In addition, the absence of an automated financial system and data base inhibited the preparation and use of summary accounting data in various control operations, such as reconciliation, and in financial reporting. Without operating general ledger systems, the Corporation relied on undocumented procedures to summarize accounting activity and to prepare its annual financial statements. Finally, the lack of operating guidance was not restricted to the Corporation's interim manual accounting. As the various components of the new system began operating, accounting personnel still did not have the guidance needed to accurately and consistently process transactions into the new system.

These conditions can lead to significant errors. For example, at the end of fiscal year 1989, in entering cumulative accounting data from manual working papers into the FARS to generate a set of fiscal year-end general ledger balances, the Corporation discovered that it had not correctly accounted for and controlled more than \$150 million in trust fund

assets. While the Corporation adjusted its fiscal year 1989 ending general ledger balances and financial statements to recognize a gain resulting from discovering these assets, it was not until fiscal year 1990 that the Corporation reworked and corrected its interim trust accounting to determine accurate balances and confirm the \$150 million fiscal year 1989 adjustment. For the first 6 months of fiscal year 1990, the Corporation continued to account for trust fund activity on a manual "ad hoc" basis. After that point, it began processing periodic trust fund accounting transactions into FARS.

During fiscal year 1990, the lack of adequate accounting controls also contributed to the Corporation's inability to

- systematically reconcile either its accounting data with various internal feeder systems or its investment and fund activity with applicable custodian banks and the Department of the Treasury;
- control its accounts receivable through a subsidiary tracking system designed to facilitate the billing, monitoring, and collecting of amounts due to the Corporation; and
- promptly prepare and file reliable external reports.

According to Corporation officials, at the end of fiscal year 1990, substantial progress had been made in implementing FARS. These officials told us that by fiscal year 1992 they expect to be able to process most, if not all, accounting transactions into FARS in an accurate and timely manner.

Discussion and Analysis of the Corporation's Reported Financial Condition

Although unaudited, the Corporation's financial statements point to an uncertain financial future. For the fiscal year ended September 30, 1990, the Corporation reported an operating loss of \$780 million, increasing its accumulated deficit by more than 75 percent, to \$1.8 billion. In contrast to fiscal year 1990, the Corporation's fiscal year 1989 financial statements reported net income of \$451 million, which reduced its previous accumulated deficit by more than 30 percent, to approximately \$1 billion. The dramatic \$1.2 billion swing in operating performance between fiscal years 1989 and 1990 is due to a large increase in the Corporation's accrual for probable losses on future plan terminations, its losses on invested assets reflecting the market decline in the value of equity investments, and the decline in the expected recovery value of receivables due on terminated plans.

While the guarantee program is considered self-financing, the Corporation's reported financial condition as of September 30, 1990, indicates that since the Corporation's inception, it has not received sufficient income from premiums and investments to fund its operating expenses, including its losses from terminated plans and those ongoing plans expected to terminate with the Corporation. However, with \$2.6 billion in cash and investments, and annual premium income of approximately \$680 million, the reported accumulated deficit does not pose an immediate risk to the Corporation's ability to pay currently guaranteed benefits and administrative expenses. In fiscal year 1990, these amounts totaled approximately \$437 million. While the Corporation now has sufficient assets to meet its near-term benefit payment obligations, sponsors of ongoing plans will be expected to finance the current \$1.8 billion funding shortfall in addition to financing the future cost of the guarantee program.

The Corporation faces significant risk from underfunded plans concentrated in specific industries. In its fiscal year 1990 annual report, the Corporation reported some \$20 billion to \$30 billion in plan underfunding, much of which is concentrated in the steel, automotive, and airline industries.² The funding status of these plans is of even greater concern given that these data were based on information reported as of December 1989. The continuing effects of the current economic downturn on these industries could hinder future employer pension plan contributions.

The most immediate risk to the Corporation from underfunded plans is presented by financially troubled companies in bankruptcy or those close to it. The Corporation's fiscal year 1990 annual report disclosed more than \$8 billion in such underfunding. Again, since this information was developed in support of the fiscal year 1990 financial statements, it does not include the effect of recent events, such as the Corporation's decision to seek the termination of PAN AM Corporation's pension plans. While the Corporation's fiscal year 1990 financial statements included an estimated loss for the expected PAN AM plan termination, the Corporation expects further losses to occur.

²The extent of concentration can be seen in the Corporation's Spring 1991 disclosure of the 50 companies responsible for the largest underfunded defined benefit pension plans. Of the \$14 billion in underfunding disclosed for the 50 companies, \$5 billion, or 35 percent, was attributable to companies in the steel industry; \$4.1 billion, or 29 percent, to the automotive industry; and \$1.5 billion, or 11 percent, to the airline industry.

Although the Corporation's financial future will be affected by economic trends, and particularly by the economic well-being of troubled industries, its financial future will also depend on

- effective management of the Corporation's pension guarantee programs,
- effective oversight of private pension plans to detect problems early, and
- the continued broad-based participation in the guarantee program by pension plan sponsors.

If many of the plans which make up the \$20 billion to \$30 billion in underfunding terminate in the near future, there would be great concern as to whether the Corporation's premium structure could be adjusted to meet the resulting funding needs. Such events could raise the possibility of federal assistance to either the Pension Benefit Guaranty Corporation or to the troubled companies, as occurred with the Chrysler Corporation in the late 1970s.

Recent Corporation Action to Address the Identified Weaknesses

After we presented the results of our work to Corporation officials, they acknowledged the significance of the internal control and financial system weaknesses we identified. The Corporation has begun a series of corrective actions which are intended to resolve these weaknesses. These reforms include specific efforts designed to (1) document and support the Corporation's use of liability estimating techniques and assumptions, (2) fully implement the premium processing system, enabling the complete processing of all premium filing information, and (3) complete the implementation of the FARS and develop appropriate accounting procedures.

In addition, during fiscal year 1991, two other actions were undertaken which offer an opportunity to improve corporationwide financial management. The Corporation began a formal review and assessment of internal controls and financial systems which should serve as a foundation for integrating internal and system controls into the Corporation's operation. Finally, in response to the basic financial management weaknesses raised in this report and consistent with the requirements for executive agencies recently enacted by section 205 of the Chief Financial Officers Act (Public Law 101-576), the Corporation's Executive Director appointed the Corporation's first Chief Financial Officer with broad responsibilities over the Corporation's financial management. We are encouraged by management's response to the weaknesses identified during our audit as well as the financial management reforms

underway. However, the ultimate success of these reforms will depend on management's commitment to correcting these weaknesses. We will continue to closely monitor and evaluate management's progress.

Conclusions

Significant system and control weaknesses in liability estimation and premium and accounting operations prevent the Corporation from carrying out some of its basic responsibilities, including

- diligently accounting for and controlling assets acquired through plan termination and premium operations;
- accurately measuring its liabilities for future benefits to provide the Congress with a basis for determining if premium levels are adequate to meet its long-term obligations; and
- reliably reporting to the Congress and the public on its financial condition using financial information and systems that can withstand independent review and evaluation.

Weaknesses discussed in this report did not arise in fiscal year 1990. In our previous attempts, we have been unable to express an opinion on the financial statements because of serious weaknesses in accounting and internal controls. While Corporation officials have attempted to address past reported weaknesses, their recurring nature demonstrates an ineffective commitment, in the past, to establishing and maintaining effective internal controls and sound financial systems.

It is imperative that the Corporation resolve the serious financial system and internal control weaknesses that impair its ability to effectively manage the pension guarantee program. Only by instituting the financial management reforms needed to resolve the reported weaknesses will the Corporation be able to reliably report its financial condition and assess the adequacy of its premium levels to make timely and uninterrupted benefit payments on terminated plans.

The serious problems facing the Corporation are not restricted to financial systems and internal controls. The concentration of underfunded plans sponsored by companies experiencing severe financial distress also poses a serious problem to the Corporation and its guarantee program.

Recommendations

Given the nature and extent of the identified system and control weaknesses, we recommend that the Corporation's Executive Director take action to ensure that, with regard to liability estimation,

- each of the three estimating techniques is supported by current and accurate documentation,
- assumptions underlying each estimating technique are properly documented and supported and include justifications for why each assumption represents the best estimate of the Corporation's anticipated experience,
- estimating techniques are periodically evaluated to ensure that estimates reasonably approximate the results that would be obtained from an individual participant valuation, and
- weaknesses in IPV system software and missing participant data are corrected.

Regarding premium operations, we recommend that the Corporation's Executive Director ensure that

- all PPS deficiencies are promptly corrected and recent system modifications are closely monitored to ensure that they are operating effectively,
- all processing backlogs are promptly eliminated,
- all premium filings warranting further action are promptly investigated and followed up, and
- all enforcement actions (including notifying and billing nonfilers for amounts owed) are promptly carried out.

Regarding accounting operations, we recommend that the Corporation's Executive Director ensure that

- FARS is promptly and effectively implemented, including the subsidiary functions such as accounts receivable and financial reporting;
- all accounting transactions are promptly and consistently recorded in the general ledger systems; and
- basic operating accounting procedures, including the procedures used to prepare and support the Corporation's financial statements, are promptly developed and documented.

In light of the past ineffective commitment by Corporation management to establishing and maintaining internal control and financial systems, we recommend that the Executive Director take action to (1) ensure that

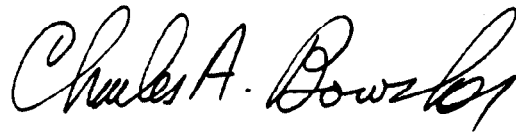
the Corporation develops specific corrective action plans, with accompanying milestones, that will address the reported weaknesses and (2) monitor the Corporation's progress in correcting the weaknesses.

Agency Comments and Our Evaluation

Commenting on a draft of this report, the Corporation's Executive Director agreed with our assessment that (1) the Corporation has serious financial system and internal control weaknesses and (2) its financial future is uncertain. In considering our recommendations, the Executive Director pointed out that the Corporation is dedicated to creating a financially sound insurance program and has made significant headway in addressing the weaknesses discussed in the report. The Executive Director disagreed with what he characterized as the report's "apparent assumption" that the sole solution to the Corporation's financial future is an adjustment in its premium structure. To this end, he referred to efforts under consideration by the Corporation and the administration which are intended to address the need for reforms to the guarantee program.

While our report points out that, in keeping with the self-financing nature of the guarantee program, sponsors of ongoing plans will be expected to finance the current deficit as well as the future cost of the guarantee program, this reference should not be construed as suggesting that increasing premiums is the only solution to the Corporation's uncertain financial future. The basic message of this report is that the Corporation needs to improve its financial management systems and practices. The Corporation's financial future depends on (1) the ability of the Corporation, the administration, and the Congress to effectively address the need for programmatic reforms and (2) implementation of financial management improvements.

We are sending copies of this report to the Secretaries of Labor, the Treasury, and Commerce in their capacities as Chairman and Members of the Board of Directors of the Corporation; the chairmen of interested congressional committees and subcommittees; and the Director of the Office of Management and Budget. Copies will be made available to others upon request.



Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

ERISA	Employee Retirement Income Security Act
FARS	Financial Accounting and Reporting Systems
GAO	General Accounting Office
IRS	Internal Revenue Service
IPV	Individual Participant Valuation
PPS	Premium Processing System
SEC	Securities and Exchange Commission

Objective, Scope, and Methodology

At the request of the Corporation's Executive Director, and in accordance with our authority under the Government Corporation Control Act (31 U.S.C. 9101-9110), we began an audit of the Corporation's financial statements for the fiscal year ending September 30, 1990. In his request, the Executive Director expressed his belief that routine independent audits provide the Corporation with a blueprint for any needed corrective action.

Our original objective was to determine the auditability of the Corporation's September 30, 1990, financial statements and, if possible, express an opinion on whether they were fairly presented. Our audit work was conducted in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of the Corporation's internal control structure and financial systems to determine the nature, timing, and extent of audit work needed to express an opinion on the Corporation's financial statements and not to provide assurance on the adequacy of the overall internal control structure and financial systems.

To obtain an understanding of the internal control structure, we reviewed relevant Corporation documents, including annual reports, financial statements, inspector general reports, and Corporation policies and procedures. We also discussed the Corporation's internal control structure with Corporation officials. This work focused on gaining an understanding of the internal control environment; relevant policies and procedures; and the methods, systems, and records established to identify, assemble, analyze, classify, record, and report the Corporation's transactions as well as those established to maintain accountability for the related assets and liabilities. Due to the significance of the Corporation's \$4.8 billion liability for future benefits and our past inability to audit the Corporation's liabilities, we focused our efforts on the Corporation's liability estimation process. We also concentrated our early work in the areas of premium and accounting operations. We supplemented our work in premium operations by monitoring and reviewing the results of the Corporation's inspector general audit of the premium operations and controls. Our work was conducted at the Pension Benefit Guaranty Corporation in Washington, D.C., primarily between March 1990 and January 1991.

Because our preliminary work identified serious financial system deficiencies and internal control weaknesses, we concluded that the financial statements were unauditible. For this reason, we limited our

objective to reporting on weaknesses in the Corporation's internal control structure, as described above. We did not pursue the detailed audit work that would normally be performed to support the expression of an opinion on the fair presentation of the Corporation's financial statements. Since we did not complete our financial audit, we did not assess the Corporation's compliance with laws and regulations that could have materially affected its financial statements as required by generally accepted government auditing standards. Instead, we reported on the results of our work. Accordingly, we did not express an opinion on the Corporation's financial statements for the fiscal year ended September 30, 1990, and we issued our disclaimer of opinion on the Corporation's fiscal year financial statements in a report to the Board of Directors dated January 3, 1991. (See appendix II for a copy of our report.)

GAO (Disclaimer of) Opinion

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-164292

To the Board of Directors of the
Pension Benefit Guaranty Corporation

At the request of the Pension Benefit Guaranty Corporation's Executive Director and in accordance with our authority under the Government Corporation Control Act (31 U.S.C. 9101-9110), we undertook an audit of the Corporation's financial statements for the fiscal year ended September 30, 1990. The financial statements were prepared by Corporation management and are its responsibility. Our audit objective was to obtain reasonable assurance, and express an opinion, on whether the financial statements present fairly, in all material respects, the Corporation's financial position and results of operations in conformity with generally accepted accounting principles. We determined during our preliminary audit work that the Corporation's estimated liability for guaranteed benefits was unauditable because of the nature and extent of weaknesses in the Corporation's process for estimating its fiscal year-end liability. Considering the liability's material effect on the financial statements, we did not complete the audit, and we do not express an opinion on these financial statements.

Because of the material weakness in internal controls over the liability for guaranteed benefits and other material weaknesses we identified, we caution users that the Corporation's September 30, 1990, financial statements have limited reliability. The internal control weaknesses we identified are as follows.

-- The Corporation was unable to demonstrate the reliability of its estimated liability for guaranteed benefits at fiscal year-end because of unexplained variations in preliminary tests of its plan estimates, weaknesses in estimating system software, and incomplete and missing data on pension beneficiaries. These conditions preclude us from evaluating whether the Corporation's fiscal year-end \$4.8 billion estimated liability is fairly presented.

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Appendix II
GAO (Disclaimer of) Opinion

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- Premium income may be misstated in the financial statements, and premiums due may not have been collected because of failure to promptly process premium related filing data reported by plan sponsors. Premium filing data were not processed during fiscal year 1990 because the processing system was not updated to accommodate changes in the Corporation's premium structure. While the Corporation continued to receive and deposit premium payments which accompany premium filings, not processing the filing data reduced substantially the Corporation's capacity to evaluate and, as necessary, follow up on the accuracy and completeness of premium filings by plan sponsors.
- Weaknesses in basic accounting controls, including the failure to regularly reconcile cash and investments and the lack of an operating general ledger system for trust accounting during the first 6 months of fiscal year 1990, prevented the Corporation from ensuring that financial information was promptly and accurately reported. These weaknesses expose the Corporation to the potential loss of assets.

The Corporation's financial statements show a loss of approximately \$780 million for fiscal year 1990, increasing its unfunded deficit to over \$1.7 billion. This is not an immediate liquidity problem because the Corporation has \$2.6 billion in cash and investments, plus annual premium income of approximately \$680 million, available to pay administrative expenses and benefits on terminated plans. Although not necessarily indicative of future cash requirements, administrative expenses and benefit payments reported in the financial statements for fiscal year 1990 were approximately \$437 million. Instituting financial management reforms will provide a more reliable picture of the Corporation's financial condition, including the claims it must be able to satisfy in the future.

The Corporation's financial future depends upon the continued broad-based participation in the insurance program by pension plan sponsors and the amount of future liabilities the Corporation may incur as a result of

- an increase in termination claims on underfunded plans that are likely to arise from a general downturn in the

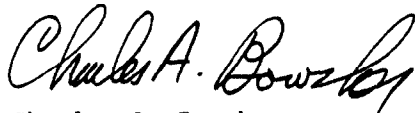
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economy, as well as the Corporation's exposure from the airline industry and other troubled sectors of the economy and

- weaknesses in oversight of pension plans, including limited scope audits of private pension plans.

Corporation management has acknowledged the significance of the internal control weaknesses we identified and noted that it has begun efforts to address them. We are encouraged by the response and will continue to closely monitor the Corporation's progress.



Charles A. Bowsher
Comptroller General
of the United States

January 3, 1991

GAO/AFMD-91-48

Financial Statements

Statements of Financial Condition (Unaudited)

(Dollars in millions)	Single-Employer Fund		Multiemployer Fund		Total	
	September 30		September 30		September 30	
	1990	1989	1990	1989	1990	1989
Assets						
Investments, at market—Note 2	\$2,331.5	\$2,355.5	\$ 183.0	\$ 154.0	\$2,514.5	\$2,509.5
Cash	80.1	42.3	0.4	0.5	80.5	42.8
Premium receivable—Note 7	14.4	17.2	0.5	0.5	14.9	17.7
Notes receivable—financial assistance—Note 5			6.0	5.3	6.0	5.3
Due from employers, net						
Trusteed plans	340.7	336.5	0.0	0.0	340.7	336.5
Plans pending trusteeship	1.8	2.4	0.0	0.0	1.8	2.4
Other receivables—Note 3	314.2	248.2	0.6	0.3	314.8	248.5
Assets of plans pending trusteeship, at market, net—Note 2	27.8	56.7	0.0	0.0	27.8	56.7
Furniture and equipment, net	0.3	0.5	0.0	0.1	0.3	0.6
	<u>\$3,110.8</u>	<u>\$3,059.3</u>	<u>\$ 190.5</u>	<u>\$ 160.7</u>	<u>\$3,301.3</u>	<u>\$3,220.0</u>

The accompanying notes are an integral part of these financial statements.

**Appendix III
Financial Statements**

<i>(Dollars in millions)</i>	Single-Employer Fund		Multiemployer Fund		Total	
	September 30		September 30		September 30	
	1990	1989	1990	1989	1990	1989
Liabilities						
Future benefits, present value—Note 4						
Trusteed plans	\$3,618.3	\$3,608.2	\$ 15.2	\$ 17.1	\$3,633.5	\$3,625.3
Plans pending trusteeship	60.7	133.3	0.0	0.0	60.7	133.3
Net claims for probable terminations	1,111.3	242.1	0.0	0.0	1,111.3	242.1
	4,790.3	3,983.6	15.2	17.1	4,805.5	4,000.7
Nonrecoverable future financial assistance, present value, net—Note 5						
			33.2	10.9	33.2	10.9
Unearned premium	149.4	148.3	7.4	7.4	156.8	155.7
Accounts payable and accrued expenses	83.9	51.0	2.2	2.0	86.1	53.0
	5,023.6	4,182.9	58.0	37.4	5,081.6	4,220.3
Equity						
Accumulated results of operations—(deficit)	(1,912.8)	(1,123.6)	132.5	123.3	(1,780.3)	(1,000.3)
Commitments and contingencies— Notes 4, 5, 9 and 10	—	—	—	—	—	—
	\$3,110.8	\$3,059.3	\$ 190.5	\$ 160.7	\$3,301.3	\$3,220.0

The accompanying notes are an integral part of these financial statements.

**Appendix III
Financial Statements**

Statements of Operations and Changes in Equity (Unaudited)

(Dollars in millions)	Single-Employer Fund		Multiemployer Fund		Total	
	September 30		September 30		September 30	
	1990	1989	1990	1989	1990	1989
Revenues:						
Premium income—Note 7	\$ 659.4	\$ 603.2	\$ 21.2	\$ 20.4	\$ 680.6	\$ 623.6
Investment and other income—Note 8	(104.5)	387.1	14.3	15.9	(90.2)	403.0
Total	<u>554.9</u>	<u>990.3</u>	<u>35.5</u>	<u>36.3</u>	<u>590.4</u>	<u>1,026.6</u>
Expenses:						
Losses (gains) from completed and probable terminations—Note 6	927.9	163.3	0.2	(0.1)	928.1	163.2
Losses (gains) from financial assistance—Note 5			23.3	0.7	23.3	0.7
Administrative expenses	62.6	45.4	2.2	3.3	64.8	48.7
Other expenses—Note 9	172.0	0.0			172.0	0.0
Actuarial charges (credits)—Note 4	181.6	361.9	0.6	1.1	182.2	363.0
Total	<u>1,344.1</u>	<u>570.6</u>	<u>26.3</u>	<u>5.0</u>	<u>1,370.4</u>	<u>575.6</u>
Net income (loss)	(789.2)	419.7	9.2	31.3	(780.0)	451.0
Accumulated results of operations— beginning of period—(deficit)	(1,123.6)	(1,543.3)	123.3	92.0	(1,000.3)	(1,451.3)
Accumulated results of operations— end of period—(deficit)	<u>\$(1,912.8)</u>	<u>\$(1,123.6)</u>	<u>\$ 132.5</u>	<u>\$ 123.3</u>	<u>\$(1,780.3)</u>	<u>\$(1,000.3)</u>

The accompanying notes are an integral part of these financial statements.

**Appendix III
Financial Statements**

Statements of Changes in Financial Condition (Unaudited)

	Single-Employer Fund		Multiemployer Fund		Total	
	September 30		September 30		September 30	
	1990	1989	1990	1989	1990	1989
<i>(Dollars in millions)</i>						
Sources of Funds from Operations						
Net income (loss)	\$ (789.2)	\$ 419.7	\$ 9.2	\$ 31.3	\$ (780.0)	\$ 451.0
Charges to operations not affecting cash and investments:						
Depreciation	0.3	1.9	0.0	0.0	0.3	1.9
Future benefits, present value assumed	125.2	69.8	0.0	0.0	125.2	69.8
Actuarial charges	181.6	361.9	0.6	1.1	182.2	363.0
Increase in net claims for probable terminations	869.2	133.9	0.0	0.0	869.2	133.9
Increase (decrease) in nonrecoverable future financial assistance, present value			22.3	(0.3)	22.3	(0.3)
Increase in unearned premiums	1.1	4.4	0.0	1.2	1.1	5.6
Total funds provided by operations	<u>388.2</u>	<u>991.6</u>	<u>32.1</u>	<u>33.3</u>	<u>420.3</u>	<u>1,024.9</u>
Uses of Funds						
Benefit payments—current year	369.3	352.9	2.5	2.6	371.8	355.5
—prior years	0.0	34.8			0.0	34.8
Additions to furniture and equipment	0.1	0.4	(0.1)	(0.3)	0.0	0.1
Increase (decrease) in assets of plans pending trusteeship	(28.9)	27.5	0.0	(0.4)	(28.9)	27.1
Increase (decrease) in due from employers and notes receivable—financial assistance	3.6	(38.6)	0.7	(0.5)	4.3	(39.1)
Increase (decrease) in premium and other receivables	63.2	172.0	0.3	0.4	63.5	172.4
Increase (decrease) in accounts payable and accrued expenses	(32.9)	(35.0)	(0.2)	(0.7)	(33.1)	(35.7)
Total uses	<u>374.4</u>	<u>514.0</u>	<u>3.2</u>	<u>1.1</u>	<u>377.6</u>	<u>515.1</u>
Increase in cash and investments of revolving funds and trustee plans	<u>\$ 13.8</u>	<u>\$ 477.6</u>	<u>\$ 28.9</u>	<u>\$ 32.2</u>	<u>\$ 42.7</u>	<u>\$ 509.8</u>

The accompanying notes are an integral part of these financial statements.

**Appendix III
Financial Statements**

Notes to Financial Statements (Unaudited)

**Note 1—
Significant Accounting
Policies**

Certain items on the 1989 financial statements have been reclassified to conform with present year classifications.

Revolving and Trust Funds:

PBGC accounts for each insurance program's revolving and trust funds on an accrual basis. The revolving and trust funds have been combined in the financial statements for presentation purposes. However, because the single-employer and multiemployer programs are separate entities, amounts in one program may not be used by the other program. The Pension Protection Act created a new single-employer program revolving fund (the PPA Fund) that is credited with all premiums in excess of \$8.50 and all penalties and interest charged on these amounts. The PPA Fund is also credited with the earnings on PBGC's investments in that fund. Amounts in this fund may not be used to pay PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

Asset Valuation and Investment Income:

Investments are recorded at fair market value. Market values are based on the last sale of a listed security, on the mean of the "bid-and-asked" for nonlisted securities, and on a valuation model in the case of fixed-income securities that are not actively traded. Receivables are recorded at estimated value at date of maturity less an amount for future interest accruals. Any realized or unrealized gain or loss in the value of investments, after the date of a plan's termination, is included in investment income in the accompanying Statements of Operations and Changes in Equity (see Note 2).

Cash:

Cash includes cash on hand, money market instruments and other debt issues purchased with an original maturity date of ninety days or less.

Premium Receivable and Unearned Premium:

Estimated premium receivable, including penalty and interest, represents the estimated earned portion of the premium for plans that have a plan year commencing before the end of PBGC's fiscal year but for which the premium payment was not received by fiscal yearend. Unearned premium represents payments received during the fiscal year that cover the portion of a plan's year after the Corporation's fiscal yearend (see Note 7).

Notes Receivable—Financial Assistance and Nonrecoverable Future Financial Assistance, Present Value:

Financial assistance is recorded as a receivable, net of an allowance for uncollectibility determined on a case-by-case basis. The liability for estimated future financial assistance is for nonrecoverable future payments that PBGC deems to be probable and estimable for multi-employer plans that have notified the Corporation of their financial difficulties (see Note 5).

Due from Employers, Net:

Due from employers includes employer liability and contributions due from sponsors. Employer liability represents the amount due from contributing sponsors of underfunded terminated plans and members of their controlled group. Contributions represent

the amounts due but unpaid prior to termination from sponsors of terminated plans, and members of their controlled group, for which PBGC either has assumed or expects to assume trusteeship.

Both are recognized as receivables as of the date of plan termination, with values based on PBGC estimates. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the debtors. Any such future amounts realized will be reported in the period in which they accrue or are paid.

Future Benefits, Present Value:

The present value of the future benefits includes amounts for:

- (1) *Trusted Plans*—represents the present value of future payments of benefits for plans that have terminated and have been trusted by PBGC prior to fiscal yearend.
- (2) *Terminated Plans Pending Trusteeship*—represents the present value of future payments of benefits for plans that have terminated but have not been trusted by PBGC prior to fiscal yearend.

After the date of plan termination, the amounts for trusted plans and terminated plans pending trusteeship are affected by benefits paid, accrual of interest due to the passage of time, the write-off of amounts not recoverable by PBGC, changes in assumptions, and other factors. The impact of these adjustments is reported as an actuarial charge (credit) in the Statements of Operations and Changes in Equity.

- (3) *Net Claims for Probable Terminations*—includes estimates of the losses, net of plan assets and estimated employer liability, from specific plans that terminated after the Corporation's fiscal yearend, or that are expected to terminate in the foreseeable future based on the occurrence of a specific identifiable event by yearend and the expectation that either one of the distress tests stipulated under the Pension Protection Act will be met or the Corporation itself will seek termination and trusteeship of the plan (see Note 4).

Losses (Gains) from Completed and Probable Terminations:

Amounts reported as losses from completed and probable terminations on the Statements of Operations and Changes in Equity represent the difference between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, less related plan assets and estimated employer liability (see Note 6).

Administrative Expenses:

All administrative expenses are paid out of a revolving fund. The expenses are then allocated between the revolving and trust funds based on the relationship of trust assets to the present value of future benefits, including those of probable terminations, at the end of the prior fiscal year, except for those expenses that are specifically identifiable as pertaining to a trust or revolving fund.

Proportional Funding:

The trust and revolving funds each pay a pro rata portion of the benefits paid each year.

The portion that belongs to each is determined by the relationship of trust assets to the present value of future benefits as of the end of the prior fiscal year.

**Appendix III
Financial Statements**

Depreciation:

Depreciation of PBGC's furniture and equipment is calculated on a straight-line basis over the estimated useful lives of the assets. The useful lives range from 5 to 10 years. Routine maintenance repairs and leasehold improvements (the amounts of which are not material) are charged to operations as incurred.

Retirement Plan:

All permanent full-time and part-time PBGC employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984, participate in CSRS unless they elected to transfer to FERS by June 30, 1988:

The Corporation's monthly contribution to the CSRS plan equals the 7 percent of base pay contributed by employees covered by that system. For those employees covered by FERS, the Corporation automatically contributes 1 percent of base pay to the employee's Thrift Savings account and matches the first 3 percent and one-half of the next 2 percent contributed by the employee. The retirement plan expenses for 1990 and 1989 were \$2.8 million and \$2.1 million, respectively.

**Note 2—
Investments**

Premium receipts are credited to the appropriate revolving fund. These funds are invested in securities issued by the U.S. Government.

The trust funds include assets PBGC acquires or expects to acquire from terminated plans and employer liability. After being transferred to a custodian bank, these assets are invested in equity securities, fixed-income securities, and real estate.

The basis and market value of the investments by type are shown in the tables following this note. The basis indicated is cost of the asset if acquired after the date of plan termination or the market value at date of plan termination if the asset was acquired as a result of a plan's termination.

**Investments of Single-Employer Revolving Funds
and Single-Employer Trusteed Plans**

<i>(Dollars in millions)</i>	September 30,			
	1990		1989	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	\$1,448.3	\$1,448.0	\$ 972.5	\$ 986.7
Equities	724.1	757.9	1,115.8	1,206.3
Certificates of deposit	0.1	0.1	0.1	0.1
Corporate bonds	9.1	9.5	58.8	58.9
Insurance contracts	1.9	1.9	5.4	4.3
Real estate funds	61.6	79.0	71.6	75.6
Mortgages	0.7	0.6	0.2	0.2
Accrued investment income	34.5	34.5	23.4	23.4
Total	\$2,280.3	\$2,331.5	\$2,247.8	\$2,355.5

**Appendix III
Financial Statements**

**Investments of Single-Employer
Terminated Plans Pending Trusteeship**

(Dollars in millions)	September 30,			
	1990		1989	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	\$ 0.2	\$ 0.2	\$ 4.2	\$ 5.1
Equities	9.3	9.3	16.6	17.2
Corporate bonds	2.1	2.1	8.7	7.8
Insurance contracts	11.1	11.2	19.6	18.3
Cash	4.7	4.7	7.1	7.1
Other	0.3	0.3	1.2	1.2
Total	\$27.7	\$27.8	\$57.4	\$56.7

**Investments of Multiemployer Revolving Fund
and Multiemployer Trusteed Plans**

(Dollars in millions)	September 30,			
	1990		1989	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	\$178.2	\$175.7	\$144.4	\$146.5
Equities	2.9	3.0	4.1	4.3
Corporate bonds	0.0	0.0	0.2	0.2
Real estate funds	0.2	0.3	0.3	0.3
Accrued investment income	4.0	4.0	2.7	2.7
Total	\$185.3	\$183.0	\$151.7	\$154.0

**Note 3—
Other Receivables**

The Corporation's other receivables are as follows:

Other Receivables

(Dollars in millions)	September 30,	
	1990	1989
Due from sale of securities	\$ 89.1	\$ 6.2
Due from insurance companies	0.0	0.7
Due from plans expected to be restored (LTV—see Note 9)	192.4	212.7
Advances to disbursing bank for benefit payments	30.8	27.2
Miscellaneous	2.5	1.7
Total	\$314.8	\$248.5

**Note 4—
Future Benefits,
Present Value**

Trusteed Plans and Plans Pending Trusteeship:

The present value of future benefits is computed using the actuarial assumptions prescribed in PBGC's Valuation of Plan Benefits regulation (29 CFR 2619). The interest rate used reflects market conditions on September 30, 1990.

A significant portion of the future benefits is based upon estimated liability because, in many cases, PBGC has not yet made a final benefit determination. Changes in these estimates are reflected in the fiscal year in which PBGC actuarially determines or reestimates the benefits. This estimation technique includes changes in interest rates assumed, benefit payouts subsequent to the valuation date, mortality, interest accumulation on liabilities, and changes in available data.

**Appendix III
Financial Statements**

The immediate interest rates used in the actuarial assumptions were 7.75% as of September 30, 1990; 7.5% as of September 30, 1989; and 7.75% as of September 30, 1988. Comparable changes were made to the rates used to value deferred annuities.

Reconciliation of the Future Benefits, Present Value, for Trusteed Plans and Plans Pending Trusteeship for the Years Ended September 30, 1990, and September 30, 1989

(Dollars in millions)	September 30,	
	1990	1989
Single-Employer Program		
Future benefits for terminated plans, present value, at beginning of year	\$3,741.5	\$3,697.5
Actuarial charges:		
Changes in interest assumptions	\$ (79.6)	\$ 80.9
Changes in method	(0.6)	(22.6)
Changes in projecting DOPT values to 9/30:		
New terminations	(5.0)	1.1
Prior terminations	3.8	(27.8)
Changes in other data	(45.6)	2.9
Expected interest and effect of experience	<u>308.6</u>	<u>327.4</u>
Total charges (credits)	181.6	361.9
Terminations:		
Current year	146.9	91.9
Changes in prior year	<u>(21.7)</u>	<u>(22.1)</u>
Total terminations	125.2	69.8
Benefit payments:		
Current year	(369.3)	(352.9)
Prior year	<u>(0.0)</u>	<u>(34.8)</u>
Total benefit payments	<u>(369.3)</u>	<u>(387.7)</u>
Future benefits for terminated plans, present value, at end of year	3,679.0	3,741.5
Net claims for probable terminations:		
Future benefits	4,345.4	489.5
Estimated plan assets available and recoveries from employers	<u>(3,234.1)</u>	<u>(247.4)</u>
Total net claims	1,111.3	242.1
Balance at end of year—Single-Employer	4,790.3	3,983.6
Future benefits for terminated plans, present value, at end of year—Multiemployer	15.2	17.1
Total future benefits, present value, at end of year	<u>\$4,805.5</u>	<u>\$4,000.7</u>

The present value of future benefits for terminated multiemployer plans reflects benefit payments of \$2.5 million, change in interest assumption of \$(0.2) million, changes in data of \$(0.5) million, and expected interest and effect of experience of \$1.3 million during 1990.

Net Claims for Probable Terminations:

As these claims are estimates, factors that are presently not fully determinable may be responsible for actual experience differing from the estimates used. The values recorded in the preceding reconciliation table have been adjusted to the expected dates of termination.

**Appendix III
Financial Statements**

**Note 5—
Nonrecoverable Future
Financial Assistance,
Present Value, and
Losses from Financial
Assistance**

Financial assistance is granted to multiemployer plans that are insolvent as defined by the Multiemployer Pension Plan Amendments Act of 1980. The present value of non-recoverable future financial assistance is the difference between the present value of future benefits and the market value of plan assets of those plans that are expected to require future nonrecoverable financial assistance. Assets include both the plan assets as of September 30, 1990, and the present value of additional amounts expected to be paid by plan sponsors.

The losses from financial assistance include the estimated nonrecoverable future financial assistance and amount recorded for uncollectible current financial assistance. An analysis is done each year of those plans that have received assistance to determine the required allowance for uncollectible amounts.

**Allowance for Future Financial Assistance
and Losses from Financial Assistance**

(Dollars in millions)

	September 30,	
	1990	1989
Changes in allowance:		
Losses (gains) from financial assistance	\$ 23.3	\$ 0.7
Financial assistance granted (previously accrued)	(1.0)	(1.0)
Balance at beginning of year	10.9	11.2
Balance at end of year	<u>\$ 33.2</u>	<u>\$ 10.9</u>

**Notes Receivable—
Financial Assistance, Net**

(Dollars in millions)

	September 30,	
	1990	1989
Financial assistance advanced	\$ 1.0	\$ 1.3
Less: Principal payments received	0.0	0.0
Plus: Interest accrued and not paid	1.7	1.1
Subtotal	2.7	2.4
Balance at beginning of year	13.8	11.4
Balance at end of year	16.5	13.8
Allowance for uncollectible amounts	(10.5)	(8.5)
Net receivable	<u>\$ 6.0</u>	<u>\$ 5.3</u>

**Note 6—
Losses (Gains) from
Completed and Probable
Terminations**

Amounts reported as losses are the present value of future benefits less related plan assets and employer liability. The following table details the components that make up the losses:

**Losses (Gains) from Completed
and Probable Terminations**

(Dollars in millions)

	September 30,	
	1990	1989
Plans terminated:		
Present value of future benefits assumed	\$ 125.2	\$ 69.8
Less: Plan assets acquired	30.9	42.0
Plan asset insufficiency	94.3	27.8
Less: Estimated recoveries	35.4	(1.5)
Subtotal	58.9	29.3
Changes in provision for probable terminations	869.2	133.9
Losses (gains)	<u>\$ 928.1</u>	<u>\$ 163.2</u>

**Appendix III
Financial Statements**

**Note 7—
Premiums**

For both programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and a substantial penalty for late payment as well as underpayment. All of these items, less refunds, are included in premium income.

**Note 8—
Investment and
Other Income**

Investment and Other Income (Dollars in millions)	September 30,	
	1990	1989
Interest and dividends	\$ 178.4	\$ 149.1
Other income	5.7	(38.1)
Realized and unrealized gains and losses	(274.3)	292.0
Total income	\$ (90.2)	\$ 403.0

**Note 9—
Contingencies**

The *Collins* and *Page* cases were brought against PBGC as separate class actions. Plaintiffs assert that PBGC should have guaranteed benefits in plans terminating before September 26, 1980, that were vested or otherwise required under the minimum standards in Title I of ERISA but not under plan terms, and that such benefits are fully guaranteeable rather than subject to phase-in over a five-year period. (Legislation that took effect on September 26, 1980, resolved the issue for future cases.) The two cases have been consolidated and a nationwide class has been certified. The case is scheduled to be argued before the district court on February 4, 1991. These cases could have a material financial impact on PBGC's single-employer program. The certified class may include participants in up to 12,000 terminated plans. Preliminary estimates indicate that the cost to PBGC may be up to \$1 billion, including substantial administrative costs, but likely will be much less.

In June the Supreme Court upheld PBGC's restoration of three LTV Steel pension plans. After the Supreme Court decision, the case was remanded to the district court where PBGC moved for entry of judgment in accordance with the Supreme Court's decision. LTV, however, sought to block restoration of one of the plans (the J&L Hourly Plan), alleging that it had no assets. The district court rejected LTV's arguments and restored all three plans after yearend.

The Internal Revenue Service and PBGC issued regulations in October 1990 granting PBGC authority to establish funding schedules for the three restored LTV Steel pension plans. In November, PBGC put out for comment proposed funding schedules for the plans. Under those schedules, PBGC assumed that the \$396 million (including interest) owed to PBGC by the restored plans would not be paid back for over 10 years. An allowance of \$172 million has been established to reflect the assumed terms of repayment.

PBGC did not attempt to restore one other terminated LTV Steel plan because it had run out of funds. PBGC has filed claims of more than \$200 million in LTV's bankruptcy proceeding for this plan. LTV and various creditors have objected to PBGC's claims and filed counterclaims, resulting in litigation in the bankruptcy and district courts. In May the bankruptcy court issued recommendations that, if adopted by the higher courts, would substantially reduce PBGC's recoveries. However, PBGC does not believe those recommendations will be adopted and therefore believes it will recover fully on its claims. Therefore, the full amount of the claim is included less an allowance to reflect the expected timing of the receipt.

Although management and counsel believe that PBGC's position in the *Collins* and *LTV* matters will be upheld by the courts, neither can predict with certainty the final outcome of this

Appendix III
Financial Statements

litigation. A contrary resolution of these legal matters would have a material impact on the financial condition of the Corporation and the results of operations as reported in the financial statements.

There are a number of other possible large single-employer plan terminations and some multiemployer plans that may require financial assistance. PBGC estimates the total unfunded amount on termination of the single-employer plans that represent reasonably possible losses is approximately \$8 billion. In addition, the liability for multiemployer plans that may require financial assistance is approximately \$100 million. There also are a number of other sponsors with plans that have significant unfunded guaranteed benefits, who could have a financial incentive to terminate if they have serious financial difficulty. No provision has been made in the financial statements for PBGC's potential liabilities upon termination of such plans, since the likelihood of these liabilities occurring is uncertain and cannot be estimated with sufficient reliability.

Litigation continues over the amount of employer liability owed to PBGC by Navistar (formerly International Harvester) following the sale of its Wisconsin Steel division and the subsequent termination of the pension plans covering Wisconsin Steel employees. The U.S. District Court for the Northern District of Illinois issued a decision upholding PBGC's claim that a sponsor cannot transfer a plan to another entity to avoid the unfunded pension liabilities. As a result of this decision, PBGC expects to receive up to \$150 million, which amount has not been included in these financial statements.

Note 10—
Commitments

PBGC leases its office facility under a commitment that expires on December 31, 1993. Annual payments through September 30, 1993, are expected to be:

1991	\$4,426,000
1992	4,670,000
1993	4,950,000
1994	1,312,000

The lease may be renewed at the option of PBGC for an additional five years after December 31, 1993, at an approximate annual average payment of \$6,818,000 per annum.

Note 11—
Financing

ERISA requires that the PBGC programs be self-financing. The Corporation finances its operations through premiums collected from covered plans, investment income, and the collection of employer liability payments due under ERISA as amended. In addition, PBGC may borrow up to \$100 million from the U.S. Treasury to finance its operations. The Corporation did not use this borrowing authority during the years ended September 30, 1990, or September 30, 1989, nor is use of this authority currently planned.

ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

Note 12—
President's Budget

A few differences appear between the financial statements and results reflected in the President's Budget. These differences are attributable to the write-down of the LTV receivable and differences in classification. Payments to participants in the three restored LTV Steel plans are shown in the President's Budget but are not treated as benefit payments by PBGC herein.

Related GAO Products

Pension Benefit Guaranty Corporation: Weak Financial Condition Worsened by Serious Internal Control Weaknesses (GAO/T-AFMD-91-9, August 1, 1991).

Letter to the Executive Director, Pension Benefit Guaranty Corporation, dated January 17, 1986, addressing our inability to express an opinion on the Corporation's fiscal year 1984 and 1985 financial statements.

Review of the Pension Benefit Guaranty Corporation's Progress Towards Improving Accounting and Internal Control Weaknesses (GAO/AFMD-84-2, November 22, 1983).

Disclaimer of Opinion on the Financial Statements of the Pension Benefit Guaranty Corporation for the Fiscal Year Ended September 30, 1980 (GAO/AFMD-82-42, June 23, 1982).

Examination of Financial Statements of the Pension Benefit Guaranty Corporation for the Fiscal Year Ended September 30, 1977 (GAO/HRD-79-44, May 3, 1979).

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