PBGC
U.S. GOVERNMENT AGENCY

Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Audit of the Pension Benefit Guaranty Corporation's Fiscal Years 1999 and 1998 Financial Statements

Report of Independent Accountants

Report on Internal Control

Report on Compliance With Applicable Laws and Regulations

Pension Benefit Guaranty Corporation's
Fiscal Years 1999 and 1998 Financial Statements
and Notes to the Financial Statements

March 31, 2000

2000-7/23138-2

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

PBGC
25 Years of Pension Protection

Office of Inspector General

To the Board of Directors
Pension Benefit Guaranty Corporation

This letter transmits the PricewaterhouseCoopers LLP reports on the audit of the Fiscal Years (FYs) 1999 and 1998 financial statements of single-employer and multiemployer program funds administered by the Pension Benefit Guaranty Corporation (PBGC) and the results of the Office of Inspector General's (OIG) review thereon.

The Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576), as amended, requires PBGC's Inspector General or an independent external auditor, as determined by the Inspector General, to audit PBGC's financial statements. The audit is to be performed in accordance with *Government Auditing Standards* as issued by the Comptroller General of the United States and other applicable requirements.

PricewaterhouseCoopers issued an unqualified opinion on the FYs 1999 and 1998 financial statements of single-employer and multiemployer program funds administered by PBGC, and also issued two additional reports - an unqualified opinion on PBGC management's assertion about the effectiveness of its internal control and a report on PBGC's compliance with laws and regulations. The audit, however, identified four reportable conditions in PBGC's internal control.

1. PBGC needs to integrate its financial management systems and improve its systems development life cycle methodology;
2. PBGC needs to improve and fully test its plan for maintaining continuity of operations;
3. PBGC needs to further improve controls surrounding the Participant Records Information Systems Management application; and
4. PBGC needs to further strengthen controls to protect its information.

To fulfill our responsibility under the CFO Act, we monitored the quality of audit work performed in accordance with *Government Auditing Standards*. Specifically, we:

- reviewed PricewaterhouseCoopers' approach and planning of the audit;
- evaluated the qualifications and independence of its auditors;
- monitored the progress of the audit at key points;
- examined its working papers and reports to evaluate compliance with *Government Auditing Standards*; and
- performed other procedures that we deemed necessary.

Based on the results of our review, the OIG determined that PricewaterhouseCoopers planned, executed, and reported the results of its audit of the FYs 1999 and 1998 financial statements of single-employer and multiemployer program funds administered by PBGC in accordance with applicable standards. Therefore, in our opinion, PricewaterhouseCoopers' work generally provides a reasonable basis on which to render its reports, and we concur with its reports.

PBGC provided comments on this report that we have considered and incorporated where applicable.

Wayne Robert Poll

Wayne Robert Poll
Inspector General

February 23, 2000

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 1999 and 1998 Financial Statements

Audit Report 2000-7/23138-2

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Abbreviations

AICPA	American Institute of Certified Public Accountants
CSRS	Civil Service Retirement System
ERISA	Employee Retirement Income Security Act of 1974
FAM	Financial Audit Manual
FARS	Financial Accounting and Reporting System
FERS	Federal Employees Retirement System
FMFIA	Federal Managers' Financial Integrity Act of 1982
FRS	Financial Reporting System
GAO	U.S. General Accounting Office
ID	Identification
IPS	Image Processing System
IRMD	Information Resource Management Department
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PBGC	Pension Benefit Guaranty Corporation
PLUS	Pension and Lump Sum System
PRISM	Participant Records Information Systems Management
PVFB	Present Value of Future Benefits
SDLC	Systems Development Life Cycle
SSB	State Street Bank
TAS	Trust Accounting System
The Fund	Single-Employer Fund
94GAM	1994 Group Annuity Mortality Table

Section I

Report of Independent Accountants

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Report of Independent Accountants

To the Inspector General
Pension Benefit Guaranty Corporation

We have audited the accompanying statements of financial condition as of September 30, 1999 and 1998, of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC or the Corporation) and the related statements of operations and changes in net position and statements of cash flows for the years then ended. These financial statements are the responsibility of PBGC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 1999 and 1998, and the results of their operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

By law, PBGC's Single-Employer Program Fund (the Fund) must be self-sustaining and as such, its premiums must be sufficient to cover both its short and long-term obligations. The Fund is able to meet its short-term benefit obligations and internal analyses indicate that the combined effect of future premium revenue and reduced underfunding of single-employer plans may allow the Fund to meet its future obligations as well. While the Fund's statement of financial condition reports a net position (assets in excess of liabilities) of $7.0 billion at September 30, 1999, losses that are "reasonably possible" as a result of unfunded vested benefits are estimated to be in the range of $17 billion to $19 billion, as discussed in Note 8. To the extent contingent losses currently classified as "reasonably possible" become more likely, such as from deteriorating economic conditions or from insolvency of a large plan sponsor, the Fund's net position could be depleted.

The Actuarial Valuation and other supplemental information contain a wide range of data, some of which are not directly related to the principal financial statements. We do not express an overall opinion on this

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information. However, we compared this information for consistency with the principal financial statements and discussed the methods of measurement and presentation with PBGC officials. Based on this limited work, we found no material inconsistencies with the principal financial statements.

In addition, in accordance with *Government Auditing Standards*, we have issued reports dated January 14, 2000, on PBGC management's assertion about the effectiveness of its internal control and on its compliance with laws and regulations.

PricewaterhouseCoopers LLP

January 14, 2000
Arlington, Virginia

Section II

Report on Internal Control

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Independent Accountants' Report on Internal Control

To the Inspector General
Pension Benefit Guaranty Corporation

We have examined management's assertion that the Pension Benefit Guaranty Corporation's (PBGC) controls in effect as of September 30, 1999, provided reasonable assurance that assets were safeguarded from material loss and transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, PBGC controls provided reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds. This assertion is included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of PBGC's fiscal year 1999 Annual Report to the Congress. Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA), *Government Auditing Standards,* and pursuant to the methodology set forth in the U.S. General Accounting Office's (GAO) *Financial Audit Manual* (FAM) and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that PBGC's controls in effect as of September 30, 1999, provided reasonable assurance that assets were safeguarded from material loss and transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, that PBGC controls provided reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds is fairly stated, in all material respects, based upon criteria contained in the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the AICPA. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions we noted were: the need for PBGC to integrate its financial management systems and improve its systems development life cycle methodology; the need for PBGC to improve and fully test its plan for maintaining continuity of operations; the need for PBGC to further improve controls surrounding the Participant Records Information Systems Management application; and the need for PBGC to further strengthen controls to protect its information.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, none of the reportable conditions described below is believed to be a material weakness.

REPORTABLE CONDITIONS

1. Systems Design and Integration

Financial Management Systems Integration

In prior fiscal year audits of PBGC, we identified a lack of integration of the Corporation's financial management systems, as defined by the Office of Management and Budget's (OMB) Circular A-127, *Financial Management Systems*. PBGC's financial management systems include the Financial Accounting and Reporting System (FARS) Revolving Fund and the Trust Accounting System (TAS), which are PBGC's general ledger systems, as well as the Financial Reporting System (FRS). PBGC recognized the need for integration of its financial management systems in its Five-Year Financial Management Systems Plan and the Corporation's Integrity Act statement. As part of this plan, PBGC management anticipated implementing a new system to replace FARS Revolving Fund that would be integrated with TAS and FRS. Although the Performance Accounting System was scheduled to replace the FARS Revolving Fund during fiscal year 1998, implementation of this system was delayed and did not occur until fiscal year 2000. As a result, the lack of complete integration continues to impact the Corporation's ability to promptly and efficiently accumulate and summarize information required for internal and external financial reporting.

OMB Circular A-127 states that financial management systems should be designed to provide for effective and efficient interrelationships between systems.

> *The term "single, integrated financial management system" means a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls and data necessary to carry out financial management functions, manage financial operations of the agency and report on the agency's financial status to central agencies, Congress and the public. Unified means that the systems are planned for and managed together, operated in an*

> *integrated fashion, and linked together electronically in an efficient and effective manner to provide agency-wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs.*

The Joint Financial Management Improvement Program (JFMIP)'s "Core Financial System Requirements" document, developed for all Federal government entities, reinforces the need for integrated financial systems. This document clearly states that:

> *Financial management systems must be designed with effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within systems.*

The document lists the following integrated, financial management system attributes:

- Standard data classifications (definition and formats) established and used for recording financial events
- Common processes used for processing similar kinds of transactions
- Internal controls over data entry, transaction processing, and reporting applied consistently
- A system design that eliminates unnecessary duplication of transaction entry

In addition, the JFMIP document further states that for the development of any integrated information system, the following elements need to be incorporated:

- The scope of the functions to be supported (processes)
- How data quality will be assured (data stewardship)
- The information to be processed (management information)
- How systems fit together to support the functions (systems architecture)
- Safeguards needed to ensure the integrity of operations and data (internal control)

Given the lack of integration of its financial management systems, PBGC did not meet the requirements of JFMIP and OMB Circular A-127. As noted in previous years, PBGC's financial management systems did not promote efficiencies in processing financial data and were not able to avoid the manual re-keying of transactions or extraction of data.

Systems Development Life Cycle (SDLC) Methodology

In addition to the lack of financial management systems integration, we have reported in prior years that PBGC had not formalized and implemented an SDLC methodology. We found that improvements in this area were still needed as of September 30, 1999. In general, an SDLC methodology defines the standards for effectively managing software development and includes the following:

- Analysis - Defines the scope of the project and what the organization wants to accomplish. The requirements definition is prepared which then enables an evaluation of potential solutions.

- Design - After the project team becomes familiar with the requirements and accepted solution, specific parameters and data fields are incorporated into a design which meets the business needs.

- Construction - Reports/screens/interfaces/programs are created and tested, the entire system is tested and accepted by the business user, and policies and procedures are developed, including user manuals.

- Implementation - Data is converted or created, users are trained, the completed and accepted system is delivered to the user and put into production.

- Post-Implementation - Once implemented, a mechanism is in place to define how continued maintenance, support, and operations will be performed and monitored, ensuring an effective level of control and adherence to PBGC policies and standards.

As mentioned above, OMB Circular A-127 states that "agency financial management systems shall conform to existing applicable functional requirements for the design, development, operation, and maintenance of financial management systems". OMB Circular A-127 also addresses requirements with respect to systems documentation, training and user support, maintenance, financial management system improvements, and internal controls related to the systems. In addition, the JFMIP's "Federal Financial Management Systems Requirements" provides guidance on this subject.

During fiscal year 1998, PBGC began addressing the issue related to the lack of a formal SDLC methodology by establishing a committee led by the Information Resource Management Department (IRMD) to define and develop standards to guide software development projects. In fiscal year 1999, PBGC continued its efforts in the development of an SDLC methodology, making significant progress, including defining the foundation for the significant components required and an action plan with a specific timeline for completion and implementation of this methodology. However, the full implementation of a thorough SDLC methodology still needs to be achieved. The lack of a formalized SDLC methodology has historically impacted, and may continue to impact, data conversion efforts, security administration, user acceptance testing, reports definition, and consistency of systems development initiatives.

Systems Development Monitoring and Oversight

PBGC continues to lack specific criteria to adequately manage and monitor its systems development projects that are outsourced to vendors. In addition, the policies for monitoring outside service providers do not address the roles and responsibilities of PBGC in overseeing the service provider in areas related to security, capacity planning, back-up and recovery, and intrusion detection. As a result, inadequate security mechanisms may be implemented by outside service providers, increasing the risk of unauthorized access. During fiscal year 1999, we continued to note that the lack of specific criteria or proper monitoring impacted the adequacy of logical access controls and the initial design of front-end edits related to certain PBGC applications. PBGC is reducing its dependency on current outsourcing arrangements with outside service providers by moving systems in-house; however, those remaining contractor arrangements still require adequate management and monitoring by PBGC.

Furthermore, PBGC continues to lack the formal methodologies and requirements to monitor the development and support of its business applications that should be defined and enforced through its systems development process. Also, PBGC lacks specific mechanisms for ensuring the continued effectiveness of operational and financial management controls once systems are implemented. As a result, PBGC will continue to be vulnerable to weak security mechanisms that may be incorporated into current and future systems development efforts.

Although PBGC made progress in this area during fiscal year 1999 by including these requirements within the development framework of its SDLC methodology, it still needs to complete its efforts. In addition, an enterprise-wide implementation of this process will help ensure this methodology is used consistently in the development of business systems applications with appropriate oversight from PBGC management.

Recommendations:

We recommend that the Corporation:

- Complete its efforts to integrate its financial management systems, in accordance with OMB Circular A-127 and its Five-Year Financial Management Systems Plan. **(OIG Control Number FOD-268)**

- Develop a systems development life cycle methodology that is tailored to PBGC's environment and needs, and define a policy and associated contractor guidelines to implement this standard methodology. **(OIG Control Number IRMD-91)**

- Implement the formal systems development life cycle methodology on all systems acquisition or development projects, and require the same of contractors. **(OIG Control Number IRMD-92)**

- Identify specific criteria to allow PBGC to effectively monitor systems outsourcing relationships. **(OIG Control Number IRMD-93)**

2. Continuity of Operations

In prior fiscal year audits, we reported that PBGC had not provided the necessary attention to business continuity issues and had not fully developed and tested a thorough disaster recovery/business continuity plan. Testing of the recovery process had not been consistent, all mission-critical systems had not been identified for testing, and responsibility for disaster recovery was not clearly defined.

PBGC has made notable progress since 1998 in implementing improvements in its disaster recovery and business continuity plans. For example:

- A test of the PBGC disaster recovery plan was performed;
- Responsibility for the development of business continuity plans for the significant business units within PBGC has been established; and

- Contingency plans developed to address the Year 2000 can now be used as a basis for the further development of PBGC's business continuity plan.

While PBGC has many components of a contingency/disaster recovery plan in place, we still identified a number of deficiencies that, in our view, would impair PBGC's ability to respond effectively to a disruption in business operations as a result of a disaster or other long-term emergency. The following items still need to be accomplished:

- PBGC has not provided evidence of a formal Business Impact Analysis to identify and validate critical workloads. IRMD identified the mission-critical systems in the PBGC 1999 Disaster Recovery Test Report. However, this process only identified the systems, not the workloads relative to recovery and processing. In addition, IRMD did not prioritize or document the systems in the PBGC Disaster Recovery and Business Continuity Plan.

- The disaster recovery plan has not been updated to address the current computing environment at PBGC impacting the requirements to complete a recovery process.

- PBGC needs to identify individuals responsible for managing the disaster recovery initiative, especially if critical individuals were not available.

- Although a location where a recovery process would be initiated has been defined, it is still questionable whether the "hot site" would be available during an emergency to provide a full recovery.

- Based on the documentation provided, it appears that most of the departments in PBGC have not updated their disaster recovery and service continuity plans in several years or even established an initial plan, such as for the Participant Records Information System Management (PRISM) application. The procedures for the recovery of operations are currently inadequate. IRMD did perform a disaster recovery test in July 1999, but the recommendations from that test have not yet been incorporated into its disaster recovery plan.

- A test of the existing disaster recovery process was performed by PBGC in fiscal year 1999; however, all critical functions were not tested and no schedule of future tests, including business unit plans, has been established.

OMB Circular A-130, *Management of Federal Information Resources,* requires agencies to establish controls for assuring adequate security for all information processed, transmitted, or stored in Federal automated information systems. Appendix III of the Circular emphasizes the importance of developing a plan for restoring critical operations for a Federal agency's information systems environment. It anticipates that there will inevitably be some service interruptions to an entity's system environment. It further states that, "agency plans should assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the systems."

Although PBGC has taken some steps in fiscal year 1999 to address disaster recovery and business continuity, substantial improvements still need to be made to strengthen PBGC's process to recover from an unanticipated disruption to its service. We believe PBGC remains vulnerable should a disaster or an extended business disruption occur.

Recommendations

We recommend that PBGC:

- Conduct a Business Impact Analysis to validate all critical workloads. In addition, recovery priorities should be established and documented for mission critical systems. IRMD can serve as the central point for developing these priorities and help facilitate and coordinate the efforts required to complete this process. **(OIG Control Number IRMD-103)**

- Update the existing contingency/disaster recovery plan to reflect the current computing environment at PBGC. **(OIG Control Number IRMD-104)**

- Define a central point for coordinating all PBGC service continuity efforts. This includes the development and testing of plans for hardware, communications, and application recovery. **(OIG Control Number IRMD-105)**

- Develop detailed procedures for the recovery of PBGC operations. **(OIG Control Number IRMD-106)**

- Test its contingency/disaster recovery procedures on a regular basis, using sufficiently detailed test plans and scenarios. Review and incorporate test results, as appropriate, in the contingency/disaster recovery plan in a timely manner. **(OIG Control Number IRMD-107)**

3. Participant Record Information System Management (PRISM)

PBGC's long-term ability to provide timely benefit payments to participants of terminated pension plans and to prepare reliable financial statements is significantly dependent on its effectiveness in managing accurate and complete participant records. Prior to fiscal year 1998, PBGC contracted with State Street Bank (SSB) to maintain participant data for the Corporation. At the beginning of fiscal year 1998, PBGC implemented PRISM, an in-house database and information management system, and assumed control over the participant database. Participant records were converted from the pay-based SSB database (PLUS) to the customer-based PRISM database (Genesis).

Based on the results of our fiscal year 1998 testing, we reported that PBGC needed to implement and improve controls surrounding PRISM to reduce risks associated with the benefit payment process and participant record integrity. During fiscal year 1999, PBGC designed and implemented several important management and information technology controls related to PRISM operations, its database, and the associated application modules. While PBGC has made notable progress in addressing our past recommendations, our fiscal year 1999 audit identified areas where these controls could be further strengthened.

Data Integrity and Data Processing

During fiscal year 1999, PBGC undertook several data integrity and data processing initiatives, which led to improvements in the controls surrounding the PRISM application. However, audit procedures performed on participant records maintained in Genesis identified that the participant data anomalies still existed in the database. For example,

- Participant records did not always agree to the supporting documentation in the Image Processing System (IPS).
- Participant records, including financial records (i.e., large lump sum payments), were missing proper source documentation in IPS.

Data anomalies within PRISM are due to a combination of factors, including (1) PLUS data errors that were carried over to Genesis as a result of the initial data conversion, (2) data errors that were created during the initial data conversion from a pay-based to a customer-based database, and (3) input and processing errors that occurred since PRISM implementation.

In fiscal year 1999, data anomalies still remain within the PRISM database. To address these anomalies, PBGC has established a Data Working Group to analyze and prioritize data and system issues. This group's responsibility is to analyze system-related errors and inadequacies and to initiate and track resolutions for these problems.

Although this group was established in the latter part of fiscal year 1999, work has begun on developing the procedures and the establishment of the processes needed to complete their assigned operational duties. However, as a result of the limited progress made to date, their effectiveness could not be determined during our audit this year.

Controls over the transmission of benefit payment and participant data between SSB, currently PBGC's paying agent, and PBGC have been significantly improved. However, acknowledgement of the receipt of data transmitted has only been implemented for the transmission to SSB. This acknowledgement should be two-way so PBGC is assured it has received all data transmitted to it by SSB. This will reduce the risk of data loss or incomplete transmissions specifically related to ledger information.

Our testing revealed data anomalies which may impact the calculation of PVFB liability. Furthermore, any uncorrected data anomalies carried over from the legacy system, in combination with initial conversion errors and on-going input and processing errors, may result in processing of invalid transactions and may have a negative impact on the overall completeness and accuracy of participant data.

Authorization, Monitoring, and Segregation of Duties

PBGC has made notable progress in addressing the segregation of duties issues raised in the prior year. Specifically, during fiscal year 1999, the Corporation has:

- Separated the responsibility for ongoing error correction, maintenance, support, and database administration of the production and development environments;

- Strengthened the change control process thereby reducing the risk of unauthorized modifications to data or system resources;

- Transferred the system security function from the Insurance Operations Department to the Information and Resources Management Department;

- Reduced the risk of one individual initiating and approving financial transactions by removing some previously granted authority and assigning responsibilities to others; and

- Improved the reconciliation process assignment so that benefit payments are not approved and reconciled by the same person.

However, our fiscal year 1999 audit identified areas in which PBGC must still improve its controls related to authorization and monitoring of activities. The general areas where weaknesses were noted are:

- Assignment of authorization rights to individuals within specific dollar levels of authority. An individual could be assigned to any level of authorization without management approval. This increases the risk that a transaction can be authorized by an individual not approved to perform this level of authorization.

- Granting of temporary authorization rights. Granting temporary authorization rights to an individual is performed to allow for the approval and processing of transactions in a timely manner when the original authorizer is unavailable. This process does not require a certain level of PBGC approval. In addition, PBGC has not defined policy on what constitutes a temporary authorization period.

- Monitoring of activity. Monitoring of transaction or individual activities is not formalized or, sometimes, not being performed. While PRISM contains an authorization log and an audit trail for each transaction, there were no formal reports produced for independent review, nor were there specific policies and procedures requiring supervisory review of such reports. Implementation of appropriate authorization and management monitoring controls would enable PBGC to detect potential unauthorized data modifications or activity.

Other Control Deficiencies

In fiscal year 1999, PBGC continued updating its existing policies and procedures and implemented new policies and procedures to address PRISM-related changes in information processing. Although many key controls have been improved or implemented, we identified instances where improvements were still needed to address deficiencies previously identified during our fiscal year 1998 audit:

- Reconciliations between projected benefit payments as reported by the PRISM Balancer module and actual disbursements made by SSB represent an important internal control over the benefit payment process. Balancer started producing reports necessary to perform such reconciliations late in fiscal year 1998. Formal policies and procedures to perform such reconciliations were established late in fiscal year 1999. However, reconciliations were limited to resolution of only prevalent types of discrepancies and were lacking evidence of managerial review and approval. This condition persisted due to the insufficiency of established policies and procedures, including resolution of reconciling items and review and approval of reconciliation results.

- A significant data integrity control known as "Deathmatch," which was not operational in fiscal year 1998, was implemented in fiscal year 1999 with related policies and procedures formalized at the end of fiscal year 1999. This control enables the Corporation to identify deceased participants and update PRISM records accordingly, thereby reducing the risk that benefit payments may be disbursed to ineligible individuals. Although the appropriate reports were steadily produced starting in January 1999, there were no formal policies and procedures in place regarding monitoring and review by PBGC to ensure timely, accurate, and complete resolution of "Deathmatch" findings.

- Various PRISM control weaknesses related to access controls and continuity of operations are reported in the reportable conditions numbers 2 and 4.

Recommendations:

The following recommendations remain outstanding from fiscal year 1998:

- Perform an analysis of data integrity within the PRISM database and develop a formal corrective action plan. **(OIG Control Number IOD-151)**

- Analyze and improve system edits and processing controls within PRISM to minimize erroneous data input and data processing. Design and place in operation an exception reporting mechanism to mitigate the risk of unauthorized transactions processing. **(OIG Control Number IOD-152)**

- Develop and enforce formal policies and procedures to provide sufficient user guidance, foster adequate segregation of duties, and establish accountability requirements. **(OIG Control Number IOD-153)**

- Implement a reporting mechanism that provides sufficient information for a regular independent review of activities performed by PBGC and contractor personnel with administrator or equivalent access rights. **(OIG Control Number IOD-155)**

In addition to our prior year recommendations above, we recommend the following:

- Complete the implementation of the operational procedures and responsibilities of the Data Working Group. **(OIG Control Number IOD-183)**

- Develop and implement controls to ensure the receipt of all data transmitted to PBGC from its paying agent, State Street Bank. **(OIG Control Number IOD-184)**

- Develop and implement formal policies and procedures to assign dollar-level authorization rights that include management approval. **(OIG Control Number IOD-185)**

- Develop and implement formal policies and procedures for the assignment of temporary authorization rights. **(OIG Control Number IOD-186)**

- Finalize policies and procedures related to reconciliations between projected benefit payments and actual disbursements and monitor their implementation. **(OIG Control Number IOD-187)**

- Finalize "Deathmatch" policies and procedures and monitor their implementation. **(OIG Control Number IOD-188)**

4. Information Protection

PBGC's automated system environment is threatened by weaknesses in several components of its information protection control structure. Because disclosure of detailed information about these weaknesses might further compromise controls, we are providing no further details here. Instead, the specifics are presented in a separate report issued by PBGC's Office of Inspector General. The general areas where weaknesses were noted are:

- The entity-wide security program and associated weaknesses in developing, implementing, and monitoring network and distributed systems security; and

- Certification and accreditation of certain general support and major application systems.

Until corrected, these weaknesses will continue to increase the risks of unauthorized access by external and internal individuals to, and modification or disclosure of, sensitive PBGC information such as the possible

PRICEWATERHOUSECOOPERS

loss of data, loss of trust fund resources, and compromised privacy of information stored within PBGC's automated systems. PBGC needs to address the information protection issues noted above.

Recommendations

We recommend that PBGC accelerate the remedial actions needed to enhance information protection by further strengthening its entity-wide security as it relates to implementation of physical and logical computer security mechanisms and controls throughout the organization.

Specifically, we recommend that PBGC:

- Enhance, finalize, and institutionalize an entity-wide security program that promotes the strengthening of LAN and distributed systems' security; **(OIG Control Number IRMD-112)**
- Reassess the security roles and responsibilities throughout PBGC's Washington offices; **(OIG Control Number IRMD-113)**
- Reevaluate its overall organization-wide security architecture; **(OIG Control Number IRMD-114)**
- Ensure that the appropriate level of trained resources are in place to develop, implement, and monitor the PBGC security program; **(OIG Control Number IRMD-115)**
- Ensure that security plans for major applications and general support systems comply with all related guidance, including OMB and NIST; **(OIG Control Number IRMD-116)**
- Develop specific security standards for the PBGC network, UNIX, Oracle, Windows NT, and Novell environments; **(OIG Control Number IRMD-117)**
- Finalize accreditation and certification of systems; **(OIG Control Number IRMD-118)** and
- Develop and implement an ongoing entity-wide information security compliance program. **(OIG Control Number IRMD-119)**

This report is intended solely for the information and use of PBGC's Office of Inspector General, its Board of Directors, the management of PBGC, and the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

January 14, 2000
Arlington, Virginia

Section III

Report on Compliance with Applicable Laws and Regulations

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Independent Accountants' Report on Compliance with Laws and Regulations

To the Inspector General
Pension Benefit Guaranty Corporation

We have audited the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the year ended September 30, 1999, and have issued our report thereon dated January 14, 2000.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, and pursuant to the methodology set forth in the U.S. General Accounting Office's *Financial Audit Manual* (FAM). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to PBGC is the responsibility of PBGC's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of PBGC's compliance with certain provisions of the Employee Retirement Income Security Act of 1974, the Federal Managers' Financial Integrity Act of 1982, the Retirement Protection Act of 1994, the Chief Financial Officers Act of 1990, and the Anti-Deficiency Act (limited to comparing the Corporation's recorded payments to related authorized limitations on certain payments and apportionments). However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of non-compliance that are required to be reported herein under *Government Auditing Standards* or the FAM.

This report is intended solely for the information and use of PBGC's Office of Inspector General, its Board of Directors, the management of PBGC, and the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

January 14, 2000
Arlington, Virginia

Section IV

Pension Benefit Guaranty Corporation's Fiscal Years 1999 and 1998 Financial Statements and Notes to the Financial Statements

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)	Single-Employer Program September 30,		Multiemployer Program September 30,		Memorandum Total September 30,	
	1999	1998	1999	1998	1999	1998
ASSETS						
Cash and cash equivalents	$ 334	$ 693	$ 9	$ 21	$ 343	$ 714
Investments, at market (Note 3):						
Fixed maturity securities	10,188	10,530	669	712	10,857	11,242
Equity securities	7,342	6,048	3	3	7,345	6,051
Real estate and real estate investment trusts	13	39	0	0	13	39
Other	88	35	0	0	88	35
Total investments	17,631	16,652	672	715	18,303	17,367
Receivables, net:						
Sponsors of terminated plans	18	21	0	0	18	21
Sponsors of restored plans (Note 4)	0	55	0	0	0	55
Premiums (Note 10)	240	53	1	1	241	54
Sale of securities	45	23	0	0	45	23
Notes receivable	0	2	0	0	0	2
Investment income	156	123	10	8	166	131
Other	5	5	0	0	5	5
Total receivables	464	282	11	9	475	291
Furniture and fixtures, net	2	4	0	0	2	4
Total assets	$18,431	$17,631	$692	$745	$19,123	$18,376

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

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)	Single-Employer Program September 30, 1999	1998	Multiemployer Program September 30, 1999	1998	Memorandum Total September 30, 1999	1998
LIABILITIES						
Present value of future benefits, net (Note 5):						
Trusteed plans	$ 9,677	$10,446	$ 5	$ 6	$ 9,682	$10,452
Terminated plans pending trusteeship	81	90	0	0	81	90
Settlements and judgments	228	319	0	0	228	319
Claims for probable terminations	1,087	1,426	0	0	1,087	1,426
Total present value of future benefits, net	11,073	12,281	5	6	11,078	12,287
Present value of nonrecoverable future financial assistance (Note 6)			479	389	479	389
Unearned premiums (Note 10)	208	266	9	9	217	275
Accounts payable and accrued expenses (Note 7)	112	72	0	0	112	72
Commitments and contingencies (Notes 8, 9, and 15)						
Total liabilities	11,393	12,619	493	404	11,886	13,023
Net position	7,038	5,012	199	341	7,237	5,353
Total liabilities and net position	$18,431	$17,631	$692	$745	$19,123	$18,376

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

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, 1999	1998	Multiemployer Program For the Years Ended September 30, 1999	1998	Memorandum Total For the Years Ended September 30, 1999	1998
UNDERWRITING:						
Income:						
Premium (Note 10)	$ 902	$ 966	$ 23	$ 23	$ 925	$ 989
Other	3	10	0	0	3	10
Total	905	976	23	23	928	999
Expenses:						
Administrative	147	143	0	0	147	143
Other	(1)	6	0	0	(1)	6
Total	146	149	0	0	146	149
Other underwriting activity:						
Losses from completed and probable terminations (Note 11)	49	584	0	0	49	584
Losses from financial assistance (Note 6)			109	34	109	34
Actuarial adjustments (Note 5)	(113)	(219)	0	0	(113)	(219)
Total	(64)	365	109	34	45	399
Underwriting income (loss)	823	462	(86)	(11)	737	451
FINANCIAL:						
Investment income (Note 12):						
Fixed	(805)	1,994	(57)	133	(862)	2,127
Equity	1,547	121	1	0	1,548	121
Other	(14)	3	0	0	(14)	3
Total	728	2,118	(56)	133	672	2,251
Expenses:						
Investment	14	15	0	0	14	15
Actuarial charges (Note 5):						
Due to passage of time	601	621	0	0	601	621
Due to change in interest rates	(1,090)	413	0	0	(1,090)	413
Total	(475)	1,049	0	0	(475)	1,049
Financial income (loss)	1,203	1,069	(56)	133	1,147	1,202
Net income (loss)	2,026	1,531	(142)	122	1,884	1,653
Net position, beginning of year	5,012	3,481	341	219	5,353	3,700
Net position, end of year	$ 7,038	$5,012	$ 199	$341	$ 7,237	$5,353

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

PENSION BENEFIT GUARANTY CORPORATION
`TATEMENTS OF CASH FLOWS

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, 1999	1998	Multiemployer Program For the Years Ended September 30, 1999	1998	Memorandum Total For the Years Ended September 30, 1999	1998
OPERATING ACTIVITIES:						
Premium receipts	$ 658	$ 967	$ 23	$ 24	$ 681	$ 991
Interest and dividends received, net	710	673	43	41	753	714
Cash received from plans upon trusteeship	17	67	0	0	17	67
Receipts from sponsors	18	48	0	0	18	48
Other receipts	71	9	0	3	71	12
Receipts of notes receivable	1	1	0	0	1	1
Benefit payments - trusteed plans	(886)	(839)	(1)	(1)	(887)	(840)
Financial assistance payments			(19)	(6)	(19)	(6)
Settlements and judgments	(125)	(40)	0	0	(125)	(40)
Payments for administrative and other expenses	(158)	(148)	0	0	(158)	(148)
Net cash provided by operating activities (Note 14)	306	738	46	61	352	799
INVESTING ACTIVITIES:						
Proceeds from sales of investments	5,727	7,537	88	214	5,815	7,751
Payments for purchases of investments	(6,392)	(8,135)	(146)	(274)	(6,538)	(8,409)
Net cash used in investing activities	(665)	(598)	(58)	(60)	(723)	(658)
Net increase (decrease) in cash and cash equivalents	(359)	140	(12)	1	(371)	141
Cash and cash equivalents, beginning of year	693	553	21	20	714	573
Cash and cash equivalents, end of year	$ 334	$ 693	$ 9	$ 21	$ 343	$ 714

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

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1999 AND 1998

Note 1 -- Organization and Purpose

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and is subject to the provisions of the Government Corporation Control Act. Its activities are defined in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980, the Single-Employer Pension Plan Amendments Act of 1986, the Pension Protection Act of 1987, and the Retirement Protection Act of 1994. The Corporation insures pensions, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans that meet the criteria specified in Section 4021 of ERISA.

ERISA requires that PBGC programs be self-financing. The Corporation finances its operations through premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA as amended, and investment income. 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, 1999, or September 30, 1998, 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.

Under the single-employer program, PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by PBGC is generally equal to the present value of the future benefits (including amounts owed under Section 4022(c) of ERISA) less (1) the amounts that are provided by the plan's assets and (2) the amounts that are recoverable by PBGC from the plan sponsor and members of the plan sponsor's controlled group, as defined by ERISA.

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from PBGC to allow the plan to continue to pay participants their guaranteed benefits. PBGC recognizes assistance as a loss to the extent that the plan is expected to be unable to repay these amounts from future plan contributions, employer withdrawal liability, or investment earnings.

Note 2 -- Significant Accounting Policies

<u>Revolving and Trust Funds:</u> PBGC accounts for its single-employer and multiemployer programs' revolving and trust funds on an accrual basis. Each fund is charged its portion of the benefits paid each year. PBGC has combined the revolving and trust funds for presentation purposes in the

financial statements. The single-employer and multiemployer programs are separate programs by law and, therefore, PBGC reports them separately.

ERISA provides for the establishment of revolving funds to be used by PBGC in carrying out its duties. The revolving funds support the operational and administrative functions of PBGC and fund any deficits incurred by PBGC in trusteeing plans or providing financial assistance. Premiums collected from ongoing plans are accounted for through the revolving funds. The Pension Protection Act of 1987 created a single-employer revolving fund that is credited with all premiums in excess of $8.50 per participant, including all penalties and interest charged on these amounts, as well as investment income. 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.

The trust funds reflect accounting activity associated with: (1) trusteed plans -- plans for which PBGC has legal responsibility, (2) plans pending trusteeship -- terminated plans for which PBGC has not become legal trustee by fiscal yearend, and (3) probable terminations -- plans that PBGC determines are likely to terminate and be trusteed by PBGC. PBGC cannot exercise legal control over a plan's assets until PBGC becomes trustee, which may be several years after the date of plan termination.

Allocation of Revolving and Trust Funds: PBGC allocates revolving and trust fund assets, liabilities, income, and expenses to each program's revolving and trust funds to the extent that such amounts are not directly attributable to a specific fund. Revolving fund income is allocated on the basis of each program's average cash available for investment during the year while the expenses are allocated on the basis of each program's present value of future benefits. Revolving fund assets and liabilities are allocated on the basis of the yearend equity of each program's revolving funds. The plan assets acquired by PBGC and commingled at PBGC's custodian bank are credited directly to the appropriate fund while the earnings and expenses on the commingled assets are allocated to each program's trust funds on the basis of each trust fund's value, relative to the total value of the commingled fund.

Valuation Method: Consistent with generally accepted accounting principles outlined in Statements of Financial Accounting Standards Nos. 35 ("Accounting and Reporting by Defined Benefit Pension Plans"), 60 ("Accounting and Reporting by Insurance Enterprises"), and 87 ("Employers' Accounting for Pensions"), PBGC reports its assets and liabilities at fair value. A primary objective of PBGC's financial statements is to provide financial information that is useful in assessing PBGC's present and future ability to ensure that defined benefit pension plan beneficiaries receive benefits when due. PBGC believes that measuring its assets and liabilities at fair value provides the most relevant information to the reader.

Cash and Cash Equivalents: Cash includes cash on hand and demand deposits. Cash equivalents are securities with a maturity of one business day.

Investment Valuation and Income: PBGC bases fair values on the last sale of a listed security, on the mean of the "bid-and-asked" for nonlisted securities, or on a valuation model in the case of fixed-income securities that are not actively traded. These valuations are determined as of the end of each fiscal year. Purchases and sales of securities are recorded on the trade date. Investment income is accrued as earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are calculated using an average cost basis. Any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC (see Notes 3, 5, and 12).

Sponsors of Terminated Plans, Receivables: The amounts due from sponsors of terminated plans or members of their controlled group represent the settled claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for uncollectible amounts. PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. The Corporation will report any such future amounts realized in the period in which they accrue or are received.

Premiums: Premiums receivable represent the earned but unpaid portion of the premiums for plans that have a plan year commencing before the end of PBGC's fiscal year and past due premiums deemed collectible, including collectible penalties and interest. Unearned premiums represent an estimate of payments received during the fiscal year that cover the portion of a plan's year after the Corporation's fiscal yearend. Premium income represents revenue generated from self-assessments from defined benefit pension plans as required by Title IV of ERISA (see Note 10).

Present Value of Future Benefits (PVFB): The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay with respect to trusteed plans and terminated plans pending trusteeship. This liability is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and members of their controlled group and the assets of terminated plans pending trusteeship. PBGC also includes the estimated liabilities attributable to probable future plan terminations as a separate line item in the PVFB (net of estimated recoveries and assets). To measure the actuarial present value, PBGC used assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). PBGC also included anticipated expenses to settle the benefit obligation in the determination of the PVFB.

(1) Trusteed Plans -- represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trusteed by PBGC prior to fiscal yearend.

(2) Terminated Plans Pending Trusteeship -- represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated but have not been trusteed by PBGC prior to fiscal yearend.

(3) Settlements and Judgments -- represents estimated liabilities related to settled litigation.

(4) Net Claims for Probable Terminations -- includes reasonable estimates of the losses, net of plan assets and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in a future year. These estimated losses are based on conditions that existed as of PBGC's fiscal yearend. It is likely that one or more events subsequent to PBGC's fiscal yearend will occur, confirming the fact of the loss.

PBGC's benefit payments to participants represent a reduction to the PVFB (see Note 5).

Present Value of Nonrecoverable Future Financial Assistance: In accordance with Title IV of ERISA, PBGC provides financial assistance to multiemployer plans, in the form of loans, to enable the plans to pay guaranteed benefits to participants and reasonable administrative expenses. These loans, issued in exchange for interest-bearing promissory notes, constitute an obligation of each plan.

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by PBGC in the future to multiemployer plans that will not be able to meet their benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future guaranteed benefits and expenses and the market value of plan assets, including the present value of future amounts expected to be paid by employers, for those plans that are expected to require future assistance. The amount reflects the rates at which, in the opinion of management, these liabilities (net of expenses) could be settled in the market for single-premium nonparticipating group annuities issued by private insurers (see Note 6).

Other Expenses: These expenses represent a current period estimate of the net amount of receivables deemed to be uncollectible. The estimate is based on the most recent status of the debtor (e.g., sponsor), the age of the receivables, and other factors that indicate the element of uncollectibility in the receivables outstanding.

Losses from Completed and Probable Terminations: Amounts reported as losses from completed and probable terminations represent the difference as of the date of plan termination between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 11). In addition, the plans' net income from date of plan termination to the beginning of the fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to PBGC's inventory of terminated plans.

Actuarial Adjustments and Charges: PBGC classifies actuarial adjustments related to changes in method and the effect of experience as underwriting activity. Actuarial charges related to changes in interest rates and passage of time are classified as financial activity. These adjustments and charges represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 5).

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

Note 3 -- Investments

Premium receipts are invested in securities issued by the U.S. Government.

The trust funds include assets PBGC acquires or expects to acquire with respect to terminated plans and investment income thereon. These assets generally are held by custodian banks.

The basis and market value of the investments by type are detailed below. 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. Realized and unrealized gains and losses, in addition to interest and dividends earned on these investments, are disclosed in Note 12.

INVESTMENTS OF SINGLE-EMPLOYER REVOLVING FUNDS AND SINGLE-EMPLOYER TRUSTEED PLANS

(Dollars in millions)

	September 30, 1999		September 30, 1998	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	$10,187	$10,002	$ 9,145	$10,516
Commercial paper	34	34	0	0
Corporate bonds	152	152	13	14
Subtotal	10,373	10,188	9,158	10,530
Equity securities	4,376	7,342	4,070	6,048
Real estate and real estate investment trusts	11	13	31	39
Other:				
Insurance contracts	49	36	39	33
Mortgages	51	51	1	2
Other investments	1	1	0	0
Total	$14,861	$17,631	$13,299	$16,652

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

(Dollars in millions)

	September 30, 1999		September 30, 1998	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	$681	$669	$620	$712
Equity securities	2	3	2	3
Total	$683	$672	$622	$715

In 1999, PBGC invested in PIMCO StocksPLUS strategy and the Flagship S&P 500 Index Fund, which contained derivative instruments. The market value of PBGC's PIMCO StocksPLUS portfolio is approximately $203 million at September 30, 1999. PIMCO's objective is to exceed, net of fees, the total rate of return of the benchmark capitalization weighted Standard & Poor's ("S&P") 500 Index over a full market cycle. PBGC accomplished the objective typically, but not exclusively, by holding long positions in stock index futures while actively managing liquid debt securities backing futures positions. PBGC began investing in the PIMCO StocksPLUS strategy in fiscal year 1999. The market value of the derivatives in the Flagship S&P 500 Index Fund was approximately $28 million at September 30, 1999, as compared to approximately $41 million at September 30, 1998.

Note 4 -- Receivables, Net: Sponsors of Restored Plans

During 1999, the LTV Corporation redeemed its $48 million, 8 1/2% interest-bearing note, which was due to mature on December 31, 2020.

Note 5 -- Present Value of Future Benefits

The following table summarizes the actuarial adjustments, charges, and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 1999 and 1998.

PBGC used a 25-year select interest rate of 7.0% followed by an ultimate rate of 6.5% for 1999 and a 25-year select interest rate of 5.7% followed by an ultimate rate of 5.75% for 1998. These rates were determined to be those needed to continue to match the survey of annuity prices provided by the American Council of Life Insurers (formerly the American Council of Life Insurance). PBGC's regulations state that both the interest rate and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in the opinion of management, the liabilities (net of expenses) could be settled in the market at September 30, for single-premium nonparticipating group annuities issued by private insurers. Many factors, including Federal Reserve policy, may impact these rates.

PBGC used the 1994 Group Annuity Mortality (GAM) Static Table (with margins), set forward two years and projected 14 years to 2008 using Scale AA.

The reserve for administrative expenses in the 1999 and 1998 valuation was assumed to be 1.3 percent of benefit liabilities plus additional reserves for cases whose plan asset determinations, participant database audits, and actuarial valuations were not yet complete. The factors to determine the additional reserves were based on case size, number of participants, and time since trusteeship.

The present values of future benefits for trusteed multiemployer plans for 1999 and 1998 reflect the payment of benefits and the changes in interest assumptions, passage of time, and the effect of experience.

The resulting liability represents PBGC's best estimate of the measure of anticipated experience under these programs.

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 1999 AND 1998
(Dollars in millions)

	September 30,			
	1999		1998	
Present value of future benefits, at beginning of year -- Single-Employer, net		$12,281		$11,497
Estimated recoveries		12		12
Assets of terminated plans pending trusteeship, net		29		103
Present value of future benefits at beginning of year, gross		12,322		11,612
Settlements and judgments		(319)		(248)
Net claims for probable terminations, prior year		(1,426)		(1,108)
Actuarial adjustments -- underwriting:				
Changes in method and assumptions	$ (105)		$ (174)	
Effect of experience	(8)		(45)	
Total actuarial adjustments -- underwriting	(113)		(219)	
Actuarial charges (credits) -- financial:				
Passage of time	601		621	
Change in interest rates	(1,090)		413	
Total actuarial charges (credits) -- financial	(489)		1,034	
Total actuarial charges (credits)		(602)		815
Terminations:				
Current year	614		414	
Changes in prior year	141		(61)	
Total terminations		755		353
Benefit payments*		(901)		(847)
Estimated recoveries		(30)		(12)
Assets of terminated plans pending trusteeship, net		(41)		(29)
Settlements and judgments		228		319
Net claims for probable terminations:				
Future benefits**	2,851		3,309	
Estimated plan assets and recoveries from sponsors	(1,764)		(1,883)	
Total net claims, current year		1,087		1,426
Present value of future benefits, at end of year -- Single-Employer, net		11,073		12,281
Present value of future benefits, at end of year -- Multiemployer		5		6
Total present value of future benefits, at end of year, net		$11,078		$12,287

* The benefit payments of $901 million and $847 million include $15 million in 1999 and $8 million in 1998 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $2,851 million and $3,309 million for fiscal years 1999 and 1998, respectively, include $124 million and $119 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $2,727 million and $3,190 million, respectively, in net claims for specifically identified probables.

ASSETS OF SINGLE-EMPLOYER TERMINATED PLANS PENDING TRUSTEESHIP, NET
(Dollars in millions)

	September 30, 1999		September 30, 1998	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	$ 2	$ 2	$ 2	$ 2
Corporate bonds	17	17	10	10
Equity securities	17	17	13	14
Insurance contracts	5	5	2	2
Other	0	0	1	1
Total, net	$41	$41	$28	$29

<u>Net Claims for Probable Terminations:</u> Factors that are presently not fully determinable may be responsible for these claim estimates differing from actual experience. Included in net claims for probable terminations is a provision for future benefit liabilities for plans not specifically identified.

The values recorded in the following reconciliation table have been adjusted to the expected dates of termination.

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS
(Dollars in millions)

	September 30, 1999		1998	
Net claims for probable terminations, at beginning of year		$1,426		$1,108
New claims	$ 158		$ 284	
Actual terminations	(247)		(56)	
Eliminated probables	(51)		(26)	
Change in benefit liabilities	(243)		260	
Change in plan assets	(34)		(190)	
Change in expected recoveries	78		46	
Loss on probables		(339)*		318*
Net claims for probable terminations, at end of year		$1,087		$1,426

* See Note 11

Note 6 -- Multiemployer Financial Assistance

PBGC provides financial assistance to multiemployer defined benefit pension plans in the form of loans. An allowance is set up to the extent that repayment of these loans is not expected. Negotiations with a multiemployer plan produced a final agreement in December 1997, under which the plan repaid $3.2 million in financial assistance in January 1998.

NOTES RECEIVABLE
MULTIEMPLOYER FINANCIAL ASSISTANCE
(Dollars in millions)

	September 30, 1999	1998
Gross balance at beginning of year	$ 38	$ 35
Financial assistance payments-- current year	5**	6
Financial assistance repayment	0	(3)
Subtotal	43	38
Allowance for uncollectible amounts	(43)	(38)
Net balance at end of year	$ 0	$ 0

The losses (gains) from financial assistance reflected in the Statements of Operations and Changes in Net Position include annual changes in the estimated present value of nonrecoverable future financial assistance and assistance granted that was not previously accrued.

PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL
ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE
(Dollars in millions)

	September 30, 1999	1998
Balance at beginning of year	$389	$361
Changes in allowance:		
Losses from financial assistance	109	34
Financial assistance granted (previously accrued)	(19)**	(6)
Balance at end of year	$479	$389

** PBGC provided assistance during 1999 in a lump sum of $14 million to one plan based on an agreement. $5 million was provided in assistance to 20 other plans, in return for notes receivable. Early in fiscal year 2000, PBGC provided approximately $86 million in assistance (which had previously been recorded as a probable loss) to another plan in a lump sum.

Note 7 -- Accounts Payable and Accrued Expenses

The following table itemizes accounts payable and accrued expenses reported in the Statements of Financial Condition:

ACCOUNTS PAYABLE AND ACCRUED EXPENSES
(Dollars in millions)

	September 30, 1999	1998
Due for purchase of securities	$ 59	$33
Annual leave	3	4
Other payables and accrued expenses	50	35
Accounts payable and accrued expenses	$112	$72

Note 8 -- Contingencies

There are a number of large single-employer plans that may terminate. In addition, there are some multiemployer plans that may require future financial assistance. The amounts disclosed below represent the Corporation's best estimates given the inherent uncertainties about these plans.

PBGC estimated that total unfunded vested benefits on termination of single-employer plans that represented reasonably possible exposure as of September 30, 1999, ranged from $17 billion to $19 billion. This exposure was primarily in the steel, airline, communications, general merchandise, and transportation equipment industries. PBGC calculated this estimate as in previous years by using data obtained from filings with the government and corporate annual reports for fiscal years ending in calendar 1998. The Corporation adjusted the value reported for liabilities in the $17 billion estimate to the December 31, 1998, PBGC select interest rate of 5.3%. When available, data was adjusted to a consistent set of mortality assumptions. The Corporation eliminated plans not insured by PBGC from the data. PBGC made no provision for the possible failure of the plan sponsor to make subsequent contributions or for plan liabilities that would be incurred after that date.

PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 6) for multiemployer plans that PBGC estimated may require future financial assistance. In addition, PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of $151 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable or reasonably possible as the present value of guaranteed future benefit and expense payments as of the later of September 30, 1999, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 1999, using interest only. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts require consideration of many complex factors. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

PBGC used select and ultimate interest rate assumptions of 7.0% for the first 25 years after the valuation date and 6.5% thereafter. The Corporation also used the 1994 Group Annuity Mortality Static Table (with margins), set forward two years, projected to 2008 using Scale AA.

Note 9 -- Commitments

PBGC leases its office facility under a commitment that began on December 11, 1993, and expires December 10, 2008. The lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, PBGC is leasing space for field benefit administrators.

These leases began in 1996 and expire in 2008. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 1999, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS
(Dollars in millions)

Years Ending September 30,	Operating Leases
2000	$ 11.8
2001	12.1
2002	12.3
2003	12.2
2004	12.4
Thereafter	55.0
Minimum lease payments	$115.8

Lease expenditures were $11.7 million in 1999 and $11.7 million in 1998.

Note 10 -- Premiums

For both the single-employer and multiemployer 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 penalties on the unpaid amount for late payment or underpayment of premiums. Late payment interest continues to accrue until the premium due is paid, while the amount of penalty that can be levied is capped at 100 percent of the premium late payment or underpayment. Annual premiums for the single-employer program are $19 per participant for a fully funded plan. Underfunded single-employer plans pay an additional variable-rate charge, based on funding levels. The multiemployer premium is $2.60 per participant.

Beginning with the 1999 plan year, the final filing due date for a plan whose premium payment year begins on the first of the month is one month later than it was for the 1998 plan year; for a plan whose premium payment year begins on a date other than the first of the month, the final filing due date is two months later than it was for the 1998 plan year. The change in the premium due date resulted in approximately $255 million in cash receipts being received in FY 2000 instead of being received in FY 1999. The $255 million includes both earned and unearned premiums. The earned portion has been included in the $240 million premium receivable at 9/30/99. See Note 2 for further information on premium accounting policies.

Note 11 -- Losses from Completed and Probable Terminations

Amounts reported as losses are the present value of future benefits (including amounts owed under Section 4022(c)) less related plan assets and the present value of expected recoveries from sponsors. The following table details the components that make up the losses:

LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS -- SINGLE-EMPLOYER PROGRAM
(Dollars in millions)

	For the Years Ended September 30,					
	1999			1998		
	New Terminations	Changes in Prior Year Terminations	Total	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	$614	$141	$ 755	$414	$(61)	$353
Less plan assets	386	16	402	236	(38)	198
Plan asset insufficiency	228	125	353	178	(23)	155
Less estimated recoveries	4	(4)	0	1	(1)	0
Subtotal	$224	$129	353	$177	$(22)	155
Settlements and judgments			35			111
Probables			(339)*			318 *
Total			$ 49			$584

* See Note 5

Note 12 -- Financial Income

FINANCIAL INCOME
(Dollars in millions)

	For the Years Ended September 30,					
	1999			1998		
	Terminated Plans Pending Trusteeship	Revolving Funds and Trusteed Plans	Total	Terminated Plans Pending Trusteeship	Revolving Funds and Trusteed Plans	Total
Fixed-income securities:						
Interest earned	$0	$ 742	$ 742	$0	$ 675	$ 675
Realized gain	0	57	57	0	427	427
Unrealized gain (loss)	0	(1,661)	(1,661)	0	1,025	1,025
Total fixed-income securities	0	(862)	(862)	0	2,127	2,127
Equity securities:						
Dividends earned	1	45	46	1	50	51
Realized gain	0	513	513	0	623	623
Unrealized gain (loss)	0	989	989	0	(553)	(553)
Total equity securities	1	1,547	1,548	1	120	121
Other income (loss)	0	(14)	(14)	0	3	3
Total financial income	$1	$ 671	$ 672	$1	$2,250	$2,251

Note 13 -- Employee Benefit Plans

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 and qualified to transfer to FERS.

The Corporation's contribution to the CSRS plan, for both 1999 and 1998, was 8.51 percent of base pay for those employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 10.7 percent of base pay for both 1999 and 1998. In addition, for FERS-covered employees, PBGC automatically contributes 1 percent of base pay to the employee's Thrift Savings account, matches the first 3 percent contributed by the employee, and matches one-half of the next 2 percent contributed by the employee. Total retirement plan expenses amounted to $7 million in 1999 and $6 million in 1998.

These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to PBGC employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM accounts for federal health and life insurance programs for those eligible retired PBGC employees who had selected federal government-sponsored plans. PBGC does not offer other supplemental health and life insurance benefits to its employees.

Note 14 -- Cash Flows

The following is a reconciliation between the net income as reported in the Statements of Operations and Changes in Net Position and net cash provided by operating activities as reported in the Statements of Cash Flows.

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES
(Dollars in millions)

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
	1999	1998	1999	1998	1999	1998
Net income	$2,026	$ 1,531	$(142)	$122	$1,884	$ 1,653
Adjustments to reconcile net income to net cash provided by operating activities:						
Net appreciation in fair value of investments	29	(1,411)	101	(91)	130	(1,502)
Net income of terminated plans pending trusteeship	(2)	(10)	0	0	(2)	(10)
Loss on completed and probable terminations	49	584	0	0	49	584
Actuarial charges (credits)	(602)	815	0	0	(602)	815
Benefit payments-trusteed plans	(886)	(839)	(1)	(1)	(887)	(840)
Settlements and judgments	(125)	(40)	0	0	(125)	(40)
Cash received from plans upon trusteeship	17	67	0	0	17	67
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
(Increase) decrease in receivables	(182)	39	(2)	3	(184)	42
Increase in present value of nonrecoverable future financial assistance			90	28	90	28
Increase (decrease) in unearned premiums	(58)	(5)	0	0	(58)	(5)
Increase in accounts payable	40	7	0	0	40	7
Net cash provided by operating activities	$ 306	$ 738	$ 46	$ 61	$ 352	$ 799

Note 15 -- Litigation

PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. In addition to such recorded costs, PBGC estimates that possible losses of up to $30 million could be incurred in the event that PBGC does not prevail in these matters.