U.S. GOVERNMENT AGENCY

Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Audit of the Pension Benefit Guaranty Corporation's Fiscal Years 2000 and 1999 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 2000 and 1999 Financial Statements and Notes to the Financial Statements

March 29, 2001

2001-9/23149-2

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

Office of Inspector General

To the Board of Directors
Pension Benefit Guaranty Corporation

This letter transmits the PricewaterhouseCoopers LLP (PricewaterhouseCoopers) report on the audit of the Fiscal Years (FYs) 2000 and 1999 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.

Section 9105 of 31 U.S.C., 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 2000 and 1999 financial statements of Single-Employer and Multiemployer Program Funds administered by PBGC. In addition, PricewaterhouseCoopers issued two other 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 FY 1999 audit identified four reportable conditions in PBGC's internal control. Audit work during FY 2000 confirmed that PBGC had strengthened its controls to protect critical information to warrant downgrading the reportable condition to a less significant management letter comment. However, three other reportable conditions remain.

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; and
3. PBGC needs to further improve controls surrounding the Participant Records Information Systems Management application.

The report on PBGC's compliance with laws and regulations includes a matter of emphasis paragraph that discusses certain PBGC payments to multiemployer plans characterized as financial assistance. PBGC represents that these transactions were executed in accordance with the Employee Retirement Income Security Act of 1974 (ERISA), as amended. However, PBGC's OIG determined that further evaluation is warranted to resolve compliance issues.

To fulfill our responsibility under the statute, 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 FYs 2000 and 1999 financial statements of Single-Employer and Multiemployer Program Funds administrated by PBGC in accordance with applicable standards. Therefore, in our opinion, PricewaterhouseCoopers' work provides a reasonable basis on which to render its January 19, 2001 opinion, and we concur with its report.

A set of PricewaterhouseCoopers' reports (2001-9/23149-2) is available upon request from the PBGC's Office of Inspector General.

Sincerely,

Wayne Robert Poll
Inspector General

February 23, 2001

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2000 and 1999 Financial Statements

Audit Report 2001-9/23149-2

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Abbreviations

AICPA	American Institute of Certified Public Accountants
ALG	Automated Letter Generation
COOP	Continuity of Operations Plan
CSRS	Civil Service Retirement System
ERISA	Employee Retirement Income Security Act of 1974
FASD	Facilities and Services Department
FBA	Field Benefit Administrators
FERS	Federal Employees Retirement System
FMFIA	Federal Managers' Financial Integrity Act of 1982
FRS	Financial Reporting System
GAM	Group Annuity Mortality
IOD	Insurance Operations Department
IPS	Image Processing System
IPVFB	Integrated Present Value of Future Benefits
IRMD	Information Resource Management Department
JFMIP	Joint Financial Manager's Improvement Program
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PA	Performance Accounting
PAS	Premium Accounting System
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
TPD	Trusteeship Processing Division
TPL	Trust Plan Ledger

Section I

Report of Independent Accountants

PRICEWATERHOUSECOOPERS

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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, 2000 and 1999, of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) 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 auditing standards generally accepted in the United States of America 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, 2000 and 1999, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 $9.7 billion at September 30, 2000, losses that are "reasonably possible" as a result of unfunded vested benefits are estimated to be $5 billion, as discussed in Note 7. 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 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 19, 2001, on PBGC management's assertion about the effectiveness of its internal control and on its compliance with laws and regulations. These reports are integral parts of an audit conducted in accordance with *Government Auditing Standards*, and, in considering the results of the audit, these reports should be read along with the Report of Independent Accountants on the financial statements.

PricewaterhouseCoopers LLP

January 19, 2001
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 or the Corporation) management controls in effect as of September 30, 2000, provided reasonable assurance that assets were safeguarded from material loss and that transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, PBGC management controls provided reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America 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 2000 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) in the United States of America and *Government Auditing Standards,* 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 management controls in effect as of September 30, 2000 provided reasonable assurance that assets were safeguarded from material loss and that transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, PBGC management controls provided reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America 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 auditing standards generally accepted in the United States of America. 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; and the need for PBGC to further improve controls surrounding the Participant Records Information Systems Management application.

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 Performance Accounting (PA) System and the Trust Plan Ledger (TPL), which are PBGC's general ledger systems, as well as the Financial Reporting System (FRS). PBGC's financial management systems include the Participant Records Information System Management (PRISM), the Premium Accounting System (PAS), and the Integrated Present Value of Future Benefits (IPVFB). Although PBGC replaced the Financial Accounting and Reporting System (FARS) Revolving Fund with PA in October 1999 in efforts to integrate PBGC's financial management systems, PBGC continues to lack complete financial management system integration. 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 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, and
- 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), and
- 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, 2000. 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. 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, and completed/accepted system is delivered to the user and put into production; and
- 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.

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. Our fiscal year 2000 testing disclosed that PBGC successfully completed developing their SDLC methodology; however, PBGC needs to effectively implement it. Currently, PBGC has several projects in the development phase that will be following the new SDLC methodology. In addition, any new systems projects, including those performed by contractors, should comply with SDLC methodology. In order for effective implementation of the SDLC methodology to take place, senior management needs to support it by requiring systems related projects to adhere to the SDLC methodology developed. 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. The lack of a fully implemented 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 2000, 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. Specifically, our testing at the Department of Commerce that runs PA in the UNIX environment revealed that this system was vulnerable to several security weaknesses. 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.

Furthermore, PBGC continues to lack the formal methodologies and requirements to monitor the development and support of its business applications provided by 3rd party vendors 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.

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)**

- Implement the formal systems development life cycle methodology on systems acquisition or development projects, and require the same of contractors; and **(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. In fiscal year 2000, PBGC made progress in developing an entity-wide continuity of operations plan. PBGC identified Facilities and Services Department (FASD) as the central point for coordinating PBGC service continuity efforts. This includes the development and testing of plans for hardware, communications, and application recovery.

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. Furthermore, testing of the recovery process had not been consistent and mission-critical systems had not been completely identified for testing. Specifically we noted the following:

- PBGC did not provide 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.

- PBGC updated the existing disaster recovery plan in fiscal year 2000, but did not address the current computing environment at PBGC, including necessary mission critical systems, impacting the requirements to complete a recovery process.

- PBGC has not identified or maintained relevant contact information for individuals responsible for managing the disaster recovery initiative, especially if critical individuals were not available.

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

- PBGC performed only a partial test of the existing disaster recovery plan in fiscal year 2000; specifically, PBGC did not completely test critical functions and did not establish a formal schedule of future tests. Alternatively, PBGC conducted a Continuity of Operations Plan (COOP) test, but every department did not participate in the test. As a result, PBGC has not determined if its COOP would be effective in the event of a disaster.

OMB Circular A-130, *Management of Federal Information Resources,* requires agencies to establish controls for assuring adequate security for 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 2000 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 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 FASD-112)**

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

- Verify that adequate user workspace is available to recover PBGC operations in the event of a disaster or long-term interruption to normal business functions; **(OIG Control Number FASD-110)**

- Maintain an up-to-date listing of the disaster recovery team and backup personnel with their relevant contact information and applicable responsibilities; **(OIG Control Number FASD-111)**

- Develop detailed procedures for the recovery of PBGC operations; and **(OIG Control Number FASD-114)**

- 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 FASD-115)**

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. During fiscal year 1998, PBGC implemented PRISM system, an in-house database and information management system. The PRISM system is an integrated information system developed to support PBGC's Insurance Operations Department (IOD) in administering pension plan customers. The PRISM system also provides an automated interface to PBGC's paying agent.

Based on the results of our fiscal year 1999 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. While PBGC made notable progress in developing formal policies and procedures to administer the benefit payment process, our fiscal year 2000 audit identified areas where controls could be further strengthened.

Data Integrity and Data Processing

During fiscal year 2000, 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, the PRISM database, identified that 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); and

- 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) Pension and Lump Sum (PLUS) System 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. These data anomalies may impact both benefit payments and the calculation of the Present Value Future Benefit (PVFB) liability.

To address data anomalies surrounding PRISM, PBGC established a Data Working Group towards the end of fiscal year 1999 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. During fiscal year 2000, the Data Working Group implemented formal procedures and initiated efforts to address data anomalies. Also, PBGC initiated additional new projects to address data anomalies in PRISM. For example, PBGC completed the Automated Letter Generation (ALG) System Conversion in fiscal year 2000, which contributed to a decrease in data redundancy. Progress on other initiatives continues.

In fiscal year 2000, PBGC made notable progress in implementing functionalities to identify deceased participants and terminate benefits accordingly. PBGC implemented a data integrity control known as "Deathmatch" with related policies and procedures formalized towards the end of fiscal year 1999. This control enables the Corporation to identify deceased participants and update PRISM records to properly terminate their benefits, thereby reducing the risk that benefit payments may be disbursed to ineligible individuals. Although the appropriate "Deathmatch" reports were produced, we noted that PBGC was not consistently addressing potential deceased participants on the report and were not appropriately terminating benefits in a timely manner.

Also, we identified control weaknesses over the transmission of prepayment benefit data from PBGC to PBGC's paying agent and over the transmission of postpayment benefit data from PBGC's paying agent to PBGC. Specifically, we noted that unauthorized changes to the data during the transmission process could take place without leaving an audit trial. This weakness increases the risk of processing unauthorized benefit payments.

Currently the paying agent sends PBGC an acknowledgment file which includes the aggregate number of transactions and aggregate number of social security changes that it received from PBGC in the benefit payment data. This acknowledgement file is not sufficient to ensure the completeness and accuracy of the benefit payment data received by the paying agent. Since the benefit payment file is vulnerable to modifications during the transmission process, this acknowledgment file is not an effective tool for identifying detailed changes made to the benefit payment file.

Authorization, Monitoring, and Segregation of Duties

During the fiscal year 2000 audit, we identified control weaknesses surrounding the authorization process. The general areas where weaknesses were noted are:

- Changes to participants' payment information made by PBGC and Field Benefit Administrators (FBAs) staff are forwarded to PBGC's paying agent without appropriate levels of approval. In addition, PRISM does not generate effective audit trail reports to identify those changes to the participant's information. This condition may potentially result in processing unauthorized payments.

- Changes to participants' benefit information made by the Data Working Group are posted to participants' record directly in PRISM without appropriate levels of approval. In addition, PRISM does not generate effective audit trail reports that identify changes to participant's benefit information records. This condition may potentially result in processing unauthorized changes to participants' benefit information in PRISM.

- Monitoring of transactions 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 date modifications or activity.

- The FBAs and Trusteeship Processing Divisions (TPDs) can establish authorization assignments at specific plan and authorization threshold levels. FBAs and TPDs can potentially use this feature to circumvent the random assignment of authorizations, which is a key control of the authorization process.

Our FY 2000 testing identified inadequate segregation of duties relating to the PRISM system. The following instances were identified:

- We identified instances where FBAs had access to cases outside of their respective jurisdiction. PRISM did not properly limit access to cases within their jurisdiction.

- One group is responsible for preparing the payment file for the paying agent and processing the paying agent ledger file. This condition can potentially enable an individual to make unauthorized changes to the payment file and the payment agent ledger file.

- The Document Management Center supervisor responsible for reviewing new plan information can modify the data before updating PRISM. PBGC does not have processes in place to independently review changes the Document Management Center supervisor may make during the review process. Thus, the Document Management Center supervisor has the ability to make unauthorized changes to new participants' records.

- Currently, the same person is responsible for both reviewing new plan data for completeness and accuracy and for transferring new plan data into PRISM. While evaluating new plan data during this process, this person can also make unauthorized changes to new plan data. The lack of segregation in this area increases the risk of processing unauthorized plan information.

- In fiscal year 2000, we determined that the temporary authorizer feature is being used to define "temporary" authorizers with no end date. This feature could be used to circumvent the random assignment of authorizations, which is a key control of the authorization process management relies on. Also, one individual may be assigned multiple temporary authorizations over time, which may lead to incompatible functions being performed by the same individual.

Other Control Deficiencies

Reconciliations between projected benefit payments as reported by the PRISM and disbursements made by PBGC's paying agent represent an important internal control over the benefit payment process. PBGC performed Balancer module reconciliations between the projected benefit payments and actual benefits paid by the paying agent. While performing these reconciliations, PBGC noted several discrepancies between the two files. In response to errors noted during the Balancer reconciliation process, PBGC implemented the Trial Balance application to reconcile projected benefit payments to the payment file the paying agent received. This reconciliation process should resolve discrepancies before actual disbursements are made. Since this reconciliation was implemented at the beginning of fiscal year 2001, we were not able to assess its effectiveness.

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)**

- Enforce policies and procedures that require participants' records in PRISM contain information that is adequately supported in IPS; **(OIG Control Number IOD-172)**

- 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 IRMD-123)**

- 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 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)**

- Reassess the level of access to the PBGC's paying agent Payment and Ledger files that is given to the Management Information Specialist. The PBGC's paying agent files should not be directly modified using SQL queries and any changes made to the PBGC's paying agent files should be re-submitted for authorization; **(OIG Control Number IOD-193)**

- Restrict access to the PBGC's paying agent FTP server by limiting access to the users that need to be involved in the integration process with PBGC's paying agent. In addition, encrypt PBGC's paying agent Payment and Ledger files; **(OIG Control Number IRMD-124)**

- Add additional integrity checks to verify the integrity of the data received by PBGC's paying agent; **(OIG Control Number IOD-194)**

- Changes to the information used to process customer payments should be authorized before being sent to PBGC's paying agent or at a minimum it should be logged and reviewed regularly; and **(OIG Control Number IOD-195)**

- Changes made by the Data Working Group should be sent back for re-authorization **(OIG Control Number IOD-196)**

Our testing of controls surrounding PRISM in fiscal year 2000 resulted in additional recommendations, as noted below:

- Reassess use of the Authorizer Administration inclusion function. This functionality should be limited to special usage, logged and reviewed by PBGC management; **(OIG Control Number IOD-197)**

- Segregate duties of individuals processing PBGC's paying agent payments and PBGC's paying agent ledger files; **(OIG Control Number IOD-198)**

- Independently review changes made by the Document Management Center supervisor before they are submitted to OASD; **(OIG Control Number IOD-199)**

- Segregate the functions of uploading and evaluating data into PRISM; and **(OIG Control Number IOD-200)**

- Implement access controls in PRISM to limit user's access to cases within their jurisdiction. **(OIG Control Number IOD-201)**

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We also noted other matters involving the internal control and its operation that we will communicate in a separate letter.

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 19, 2001
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 or the Corporation) as of and for the year ended September 30, 2000, and have issued our report thereon dated January 19, 2001.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. 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 (ERISA), 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*. We identified a matter requiring emphasis as noted below.

During fiscal year 2000, PBGC executed two transactions that were characterized as multiemployer financial assistance payments. PBGC's Office of General Counsel represented that these transactions were executed in accordance with ERISA, as amended. However, PBGC's Office of Inspector General determined that further evaluation is warranted to determine whether these transactions complied with ERISA and applicable regulations. As of the date of issuance of this report, the issue has not been resolved.

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 19, 2001
Arlington, Virginia

Section IV

Pension Benefit Guaranty Corporation's Fiscal Years 2000 and 1999 Financial Statements and Notes to the Financial Statements

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2000**	1999	**2000**	1999	**2000**	1999
ASSETS						
Cash and cash equivalents	**$ 341**	$ 334	**$ 8**	$ 9	**$ 349**	$ 343
Investments, at market (Note 3):						
Fixed maturity securities	**11,719**	10,239	**671**	669	**12,390**	10,908
Equity securities	**8,186**	7,342	**3**	3	**8,189**	7,345
Real estate and real estate investment trusts	**16**	13	**0**	0	**16**	13
Other	**32**	37	**0**	0	**32**	37
Total investments	**19,953**	17,631	**674**	672	**20,627**	18,303
Receivables, net:						
Sponsors of terminated plans	**28**	18	**0**	0	**28**	18
Premiums (Note 9)	**143**	240	**1**	1	**144**	241
Sale of securities	**57**	45	**0**	0	**57**	45
Investment income	**189**	156	**11**	10	**200**	166
Other	**2**	5	**0**	0	**2**	5
Total receivables	**419**	464	**12**	11	**431**	475
Furniture and fixtures, net	**2**	2	**0**	0	**2**	2
Total assets	**$20,715**	$18,431	**$694**	$692	**$21,409**	$19,123

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, 2000	1999	Multiemployer Program September 30, 2000	1999	Memorandum Total September 30, 2000	1999
LIABILITIES						
Present value of future benefits, net (Note 4):						
Trusteed plans	**$ 9,426**	$ 9,677	**$ 4**	$ 5	**$ 9,430**	$ 9,682
Terminated plans pending trusteeship	**62**	81	**0**	0	**62**	81
Settlements and judgments	**242**	228	**0**	0	**242**	228
Claims for probable terminations	**901**	1,087	**0**	0	**901**	1,087
Total present value of future benefits, net	**10,631**	11,073	**4**	5	**10,635**	11,078
Present value of nonrecoverable future financial assistance (Note 5)			**414**	479	**414**	479
Unearned premiums (Note 9)	**206**	208	**9**	9	**215**	217
Accounts payable and accrued expenses (Note 6)	**174**	112	**0**	0	**174**	112
Commitments and contingencies (Notes 7, 8, and 14)						
Total liabilities	**11,011**	11,393	**427**	493	**11,438**	11,886
Net position	**9,704**	7,038	**267**	199	**9,971**	7,237
Total liabilities and net position	**$20,715**	$18,431	**$694**	$692	**$21,409**	$19,123

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, 2000	1999	Multiemployer Program For the Years Ended September 30, 2000	1999	Memorandum Total For the Years Ended September 30, 2000	1999
UNDERWRITING:						
Income:						
Premium (Note 9)	**$ 807**	$ 902	**$ 24**	$ 23	**$ 831**	$ 925
Other	**5**	3	**0**	0	**5**	3
Total	**812**	905	**24**	23	**836**	928
Expenses:						
Administrative	**152**	147	**0**	0	**152**	147
Other	**(2)**	(1)	**0**	0	**(2)**	(1)
Total	**150**	146	**0**	0	**150**	146
Other underwriting activity:						
Losses (credits) from completed and probable terminations (Note 10)	**(80)**	49	**0**	0	**(80)**	49
Losses from financial assistance (Note 5)			**26**	109	**26**	109
Actuarial adjustments (Note 4)	**(200)**	(113)	**0**	0	**(200)**	(113)
Total	**(280)**	(64)	**26**	109	**(254)**	45
Underwriting income (loss)	**942**	823	**(2)**	(86)	**940**	737
FINANCIAL:						
Investment income (loss) (Note 11):						
Fixed	**1,081**	(805)	**69**	(57)	**1,150**	(862)
Equity	**1,310**	1,547	**1**	1	**1,311**	1,548
Other	**1**	(14)	**0**	0	**1**	(14)
Total	**2,392**	728	**70**	(56)	**2,462**	672
Expenses:						
Investment	**15**	14	**0**	0	**15**	14
Actuarial charges (Note 4):						
Due to passage of time	**658**	601	**0**	0	**658**	601
Due to change in interest rates	**(5)**	(1,090)	**0**	0	**(5)**	(1,090)
Total	**668**	(475)	**0**	0	**668**	(475)
Financial income (loss)	**1,724**	1,203	**70**	(56)	**1,794**	1,147
Net income (loss)	**2,666**	2,026	**68**	(142)	**2,734**	1,884
Net position, beginning of year	**7,038**	5,012	**199**	341	**7,237**	5,353
Net position, end of year	**$9,704**	$ 7,038	**$267**	$ 199	**$9,971**	$ 7,237

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

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF CASH FLOWS

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
(Dollars in millions)	**2000**	1999	**2000**	1999	**2000**	1999
OPERATING ACTIVITIES:						
Premium receipts	**$ 902**	$ 658	**$ 24**	$ 23	**$ 926**	$ 681
Interest and dividends received, net	**775**	710	**49**	43	**824**	753
Cash received from plans upon trusteeship	**32**	17	**0**	0	**32**	17
Receipts from sponsors	**28**	18	**0**	0	**28**	18
Other receipts	**10**	71	**0**	0	**10**	71
Receipts of notes receivable	**0**	1	**0**	0	**0**	1
Benefit payments - trusteed plans	**(895)**	(886)	**(1)**	(1)	**(896)**	(887)
Financial assistance payments			**(91)**	(19)	**(91)**	(19)
Settlements and judgments	**(162)**	(125)	**0**	0	**(162)**	(125)
Pretermination payments	**(25)**	0	**0**	0	**(25)**	0
Payments for administrative and other expenses	**(175)**	(158)	**0**	0	**(175)**	(158)
Net cash provided (used) by operating activities (Note 13)	**490**	306	**(19)**	46	**471**	352
INVESTING ACTIVITIES:						
Proceeds from sales of investments	**12,824**	5,727	**401**	88	**13,225**	5,815
Payments for purchases of investments	**(13,307)**	(6,392)	**(383)**	(146)	**(13,690)**	(6,538)
Net cash provided (used) by investing activities	**(483)**	(665)	**18**	(58)	**(465)**	(723)
Net increase (decrease) in cash and cash equivalents	**7**	(359)	**(1)**	(12)	**6**	(371)
Cash and cash equivalents, beginning of year	**334**	693	**9**	21	**343**	714
Cash and cash equivalents, end of year	**$ 341**	$ 334	**$ 8**	$ 9	**$ 349**	$ 343

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

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2000 AND 1999

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, 2000, or September 30, 1999, 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

Revolving and Trust Funds: 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 accounting principles generally accepted in the United States of America outlined in Statements of Financial Accounting Standards Nos. 35 ("Accounting and Reporting by Defined Benefit Pension Plans"), 60 ("Accounting and Reporting by Insurance Enterprises"), 87 ("Employers' Accounting for Pensions"), and 133 ("Accounting for Derivative Instruments and Hedging Activities"), 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, 4, and 11).

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 9).

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 4).

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 5).

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 10). In addition, the plan's 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 4).

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 11.

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

(Dollars in millions)

	September 30, 2000		September 30, 1999	
	Basis	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$11,110**	**$11,299**	$10,172	$ 9,987
Commercial paper	**27**	**27**	34	34
Corporate bonds	**393**	**393**	218	218
Subtotal	**11,530**	**11,719**	10,424	10,239
Equity securities	**4,150**	**8,186**	4,376	7,342
Real estate and real estate investment trusts	**15**	**16**	11	13
Other:				
Insurance contracts	**35**	**31**	49	36
Other investments	**1**	**1**	1	1
Total	**$15,731**	**$19,953**	$14,861	$17,631

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

(Dollars in millions)

	September 30, 2000		September 30, 1999	
	Basis	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$660**	**$671**	$681	$669
Equity securities	**2**	**3**	2	3
Total	**$662**	**$674**	$683	$672

Derivative Investments: Financial Accounting Standard No. 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. PBGC has elected early adoption beginning with fiscal year 2000. The implementation had no impact on prior year statements. During fiscal years 1999 and 2000, PBGC invested in an investment product that contained Standard & Poor's (S&P) 500 financial futures contracts. The purpose of this investment strategy is to exceed, net of fees, the total rate of return over the S&P 500 Index, while maintaining a very similar risk level to that of the index. PBGC is accomplishing the objective typically, but not exclusively, by holding long positions in stock index futures while actively managing liquid debt securities backing the futures positions.

In addition to the initial margin of approximately 5 percent maintained with the broker in Treasury bills, S&P 500 financial futures contracts require daily settlement of variation margin. For the fiscal years ended September 30, 2000, and September 30, 1999, gains and losses from settled margin calls are reported in Investment Income on the Statements of Operations and Changes in Net Position. PBGC limits its investment in these derivative instruments to the aggregate investment in a single fund. At September 30, 2000, and September 30, 1999, the notional cost amount of the derivative investments (the face amount specified in the contract) was approximately $371 million and $201 million, respectively. The fair value of the derivative instruments (the amount needed to settle at September 30) reported on the Statements of Financial Condition was approximately $5 million (included in Accounts payable and accrued expenses) and $3 million (included in Receivables, net: Other) at September 30, 2000, and September 30, 1999, respectively.

The S&P 500 financial future contracts are traded on organized exchanges and thus bear minimal credit risk. The exchange clears, settles, and guarantees transactions occurring through its facilities. Institutional investors hold these future contracts on behalf of PBGC and mark to market daily. In periods of extreme volatility, margin calls may pose a liquidity threat to the underlying portfolio. To mitigate this, PBGC maintains adequate liquidity in its portfolio to meet these margin calls.

Note 4 -- 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, 2000 and 1999.

PBGC used a 25-year select interest rate of 7.0% followed by an ultimate rate of 6.75% for 2000 and a 25-year select interest rate of 7.0% followed by an ultimate rate of 6.5% for 1999. 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. 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 2000 and 1999 valuation was assumed to be 1.18 percent and 1.3 percent, respectively, 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. PBGC updated the expense model in 2000 based on a study prepared by an independent consultant.

The present values of future benefits for trusteed multiemployer plans for 2000 and 1999 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, 2000 AND 1999

(Dollars in millions)

	September 30,			
	2000		1999	
Present value of future benefits, at beginning of year -- Single-Employer, net		**$11,073**		$12,281
Estimated recoveries		**30**		12
Assets of terminated plans pending trusteeship, net		**41**		29
Present value of future benefits at beginning of year, gross		**11,144**		12,322
Settlements and judgments		**(228)**		(319)
Net claims for probable terminations, prior year		**(1,087)**		(1,426)
Actuarial adjustments -- underwriting:				
Changes in method and assumptions	**$ (109)**		$ (105)	
Effect of experience	**(91)**		(8)	
Total actuarial adjustments -- underwriting	**(200)**		(113)	
Actuarial charges (credits) -- financial:				
Passage of time	**658**		601	
Change in interest rates	**(5)**		(1,090)	
Total actuarial charges (credits) -- financial	**653**		(489)	
Total actuarial charges (credits)		**453**		(602)
Terminations:				
Current year	**439**		614	
Changes in prior year	**(42)**		141	
Total terminations		**397**		755
Benefit payments*		**(902)**		(901)
Estimated recoveries		**(205)**		(30)
Assets of terminated plans pending trusteeship, net		**(84)**		(41)
Settlements and judgments		**242**		228
Net claims for probable terminations:				
Future benefits**	**2,752**		2,851	
Estimated plan assets and recoveries from sponsors	**(1,851)**		(1,764)	
Total net claims, current year		**901**		1,087
Present value of future benefits, at end of year -- Single-Employer, net		**10,631**		11,073
Present value of future benefits, at end of year -- Multiemployer		**4**		5
Total present value of future benefits, at end of year, net		**$10,635**		$11,078

* The benefit payments of $902 million and $901 million include $7 million in 2000 and $15 million in 1999 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $2,752 million and $2,851 million for fiscal years 2000 and 1999, respectively, include $119 million and $124 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $2,633 million and $2,727 million, respectively, in net claims for specifically identified probables.

ASSETS OF SINGLE-EMPLOYER TERMINATED PLANS PENDING TRUSTEESHIP, NET

(Dollars in millions)

	September 30, 2000		September 30, 1999	
	Basis	**Market Value**	Basis	Market Value
U.S. Government securities	**$ 2**	**$ 2**	$ 0	$ 0
Corporate bonds	**14**	**14**	19	19
Equity securities	**36**	**37**	17	17
Insurance contracts	**3**	**3**	5	5
Other	**28**	**28**	0	0
Total, net	**$83**	**$84**	$41	$41

Net Claims for Probable Terminations: 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, 2000		1999	
Net claims for probable terminations, at beginning of year		**$1,087**		$1,426
New claims	**$ 36**		$ 158	
Actual terminations	**(99)**		(247)	
Eliminated probables	**(53)**		(51)	
Change in benefit liabilities	**27**		(243)	
Change in plan assets	**(35)**		(34)	
Change in expected recoveries	**(62)**		78	
Loss on probables		**(186)***		(339)*
Net claims for probable terminations, at end of year		**$ 901**		$1,087

* See Note 10

Note 5 -- 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.

NOTES RECEIVABLE
MULTIEMPLOYER FINANCIAL ASSISTANCE
(Dollars in millions)

	September 30, 2000	1999
Gross balance at beginning of year	**$ 43**	$ 38
Financial assistance payments-- current year	**4****	5**
Subtotal	**47**	43
Allowance for uncollectible amounts	**(47)**	(43)
Net balance at end of year	**$ 0**	$ 0

The losses 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, 2000	September 30, 1999
Balance at beginning of year	**$479**	$389
Changes in allowance:		
Losses from financial assistance	**26**	109
Financial assistance granted (previously accrued)	**(91)****	(19)**
Balance at end of year	**$414**	$479

** In FY 2000, PBGC provided nonrecoverable one-time financial assistance to two plans in the amount of $87 million and $4 million to 19 other plans in exchange for notes receivable. During FY 1999, PBGC provided nonrecoverable one-time financial assistance to one plan in the amount of $14 million and $5 million to 20 other plans in exchange for notes receivable.

Note 6 -- 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, 2000	September 30, 1999
Due for purchase of securities	**$144**	$ 59
Annual leave	**4**	3
Other payables and accrued expenses	**26**	50
Accounts payable and accrued expenses	**$174**	$112

Note 7 -- 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, 2000, was approximately $5 billion. This exposure was principally in primary metals and fabricated metal products (steel), air transportation, general merchandise - retail trade, electronic and other equipment, rubber and miscellaneous plastics, apparel and accessory stores, 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 1999. The Corporation adjusted the value reported for liabilities to the December 31, 1999, PBGC select interest rate of 7.0%. 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 5) 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 $119 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 net of any future contributions or withdrawal liability payments as of the later of September 30, 2000, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2000, 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 6.75% 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 8 -- 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 2009. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2000, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS
(Dollars in millions)

Years Ending September 30,	Operating Leases
2001	$ 12.1
2002	12.2
2003	12.1
2004	12.3
2005	12.5
Thereafter	42.8
Minimum lease payments	$104.0

Lease expenditures were $11.8 million in 2000 and $11.7 million in 1999.

Note 9 -- 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 and the interest due are 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.

Note 10 -- Losses (Credits) 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 (CREDITS) FROM COMPLETED AND PROBABLE TERMINATIONS -- SINGLE-EMPLOYER PROGRAM
(Dollars in millions)

	For the Years Ended September 30, 2000			1999		
	New Terminations	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$439**	**$ (42)**	**$397**	$614	$141	$ 755
Less plan assets	**302**	**(9)**	**293**	386	16	402
Plan asset insufficiency	**137**	**(33)**	**104**	228	125	353
Less estimated recoveries	**11**	**163**	**174**	4	(4)	0
Subtotal	**$126**	**$ (196)**	**(70)**	$224	$129	353
Settlements and judgments			**176**			35
Probables			**(186) ***			(339)*
Total			**$ (80)**			$ 49

* See Note 4

Note 11 -- Financial Income

FINANCIAL INCOME
(Dollars in millions)

	For the Years Ended September 30, 2000	1999
Fixed-income securities:		
Interest earned	**$ 826**	$ 742
Realized gain (loss)	**(73)**	57
Unrealized gain (loss)	**397**	(1,661)
Total fixed-income securities	**1,150**	(862)
Equity securities:		
Dividends earned	**33**	46
Realized gain	**207**	513
Unrealized gain	**1,071**	989
Total equity securities	**1,311**	1,548
Other income (loss)	**1**	(14)
Total financial income	**$2,462**	$ 672

Note 12 -- 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 2000 and 1999, 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 2000 and 1999. 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 $8 million in 2000 and $7 million in 1999.

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 13 -- 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,	
	2000	1999	**2000**	1999	**2000**	1999
Net income (loss)	**$ 2,666**	$2,026	**$ 68**	$(142)	**$ 2,734**	$1,884
Adjustments to reconcile net income to net cash provided by operating activities:						
Net appreciation in fair value of investments	**(1,624)**	19	**(20)**	101	**(1,644)**	120
Net income of terminated plans pending trusteeship	**(1)**	(2)	**0**	0	**(1)**	(2)
Loss on completed and probable terminations	**(80)**	49	**0**	0	**(80)**	49
Actuarial charges (credits)	**453**	(602)	**0**	0	**453**	(602)
Benefit payments-trusteed plans	**(895)**	(886)	**(1)**	(1)	**(896)**	(887)
Settlements and judgments	**(162)**	(125)	**0**	0	**(162)**	(125)
Cash received from plans upon trusteeship	**32**	17	**0**	0	**32**	17
Pretermination payments	**(25)**	0	**0**	0	**(25)**	0
Settlements recorded and paid in full during current year	**21**	10	**0**	0	**21**	10
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
(Increase) decrease in receivables	**45**	(182)	**(1)**	(2)	**44**	(184)
(Increase) decrease in present value of nonrecoverable future financial assistance			**(65)**	90	**(65)**	90
Decrease in unearned premiums	**(2)**	(58)	**0**	0	**(2)**	(58)
Increase in accounts payable	**62**	40	**0**	0	**62**	40
Net cash provided by operating activities	**$ 490**	$ 306	**$(19)**	$ 46	**$ 471**	$ 352

Note 14 -- 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.

Note 15 -- Subsequent Event

On December 21, 2000, the Consolidated Appropriations Act, 2001, was signed into law. The Act includes a provision that increases the maximum benefit guarantee for workers in multiemployer pension plans. The legislation marks the first increase in PBGC's multiemployer guarantee since 1980. The increased guarantee limit will apply to any multiemployer plan that had not received PBGC financial assistance during the one-year period prior to the enactment of the bill on December 21, 2000. The effect of this material increase will be accounted for in the present value of nonrecoverable future financial assistance on the Statements of Financial Condition at September 30, 2001.

Section V

Agency Comments