PBGC

Protecting America's Pensions

Pension Benefit Guaranty Corporation

Office of Inspector General

Memorandum Report

Lessons Learned from FY 2004 Financial Statement Audit

March 7, 2005

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

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MEMORANDUM

TO: Bradley Belt
Executive Director

FROM: Luther L. Atkins *Luther L. Atkins*
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SUBJECT: Lessons Learned from FY 2004 Financial Statement Audit

Introduction

In 2004, Federal agencies were required to issue audited financial statements by November 15 for the first time. Despite many obstacles, PBGC achieved a major milestone by meeting the government-wide accelerated reporting deadline and achieving an unqualified opinion for the 12th consecutive year. This was made possible by a real team effort of the Board Representatives, PBGC management and staff, PricewaterhouseCoopers, and the OIG. Much of our success was due to the Herculean efforts of this team. However, we all recognize that improved systems and processes are needed to make financial reporting a routine event each year.

To build on this year's success, OIG hosted a series of lessons learned sessions with key players in the financial reporting process. These sessions included Department Directors that participated in the financial reporting process and PricewaterhouseCoopers. In addition, these sessions provided a forum to discuss reportable conditions identified during the audit and corrective action plans. Our hope is to capitalize on the things we did well and improve in the areas where we can be more effective. This report summarizes lessons learned regarding the preparation and audit of PBGC's 2004 Financial Statement Audit.

Results in Brief

All of the participants in the sessions agree that PBGC has made significant progress in correcting internal control weaknesses this year. Two conditions reported last year were corrected----a material weakness in estimating the value of liabilities for multiemployer plans and a reportable condition for estimating single-employer reserves. While we are all encouraged at the progress, we all understand that further improvement is needed. The Corporation still has five reportable conditions that were reported in previous years.

We analyzed the input from the key players in the financial reporting process to identify things we did well and opportunities to improve. We identified several recurring themes during our sessions:

1. Management needs to continue its strong commitment to and support of the financial reporting process.
2. Communications during planning, execution and follow-up improved this year, but there are opportunities to improve communications.
3. Most of the recommendations for reportable conditions and management letter issues relate to documentation of processes and procedures.
4. 4010 data is needed sooner and more often.

While all of these lessons are important, auditors believe there are two challenges that need to be addressed strategically to have the November 15 deadline become a routine business practice (rather than an extraordinary task):

- Close the financial records, including conducting the processes that support the financial statements, more often during the year to reduce the pressure on management and auditors at year-end, and
- Improve financial controls by integrating financial systems.

By addressing both of these challenges, management will not only streamline financial reporting but will improve its financial and performance management with more timely and accurate information.

Based on the discussions at the sessions we hosted, one thing is crystal clear---the lessons learned sessions were valuable because they encouraged a constructive dialogue between all of the players. We plan to continue this practice after the audited financial statements are issued in 2005.

1. Management Commitment. The most important ingredient to successful financial reporting is a strong commitment from top-level management to support reporting and implement strong controls. Throughout the year, the Executive Director, Chief Financial Officer, and Chief Operating Officer took a keen interest in the financial audit and meeting the accelerated reporting deadline. The executives' unwavering support to meet the mandated November 15 reporting deadline signaled the priority that management was expected to give this important task. In staff meetings and periodic coordination meetings with the audit staff, the executives publicly emphasized the importance of correcting reportable conditions.

Likewise, the OIG and PwC made a strong commitment to completing the financial audit on time. From the beginning, auditors placed a high priority on identifying issues that would be barriers to completing the audit. When issues were identified, they were promptly resolved through meetings and, if necessary, elevated to successively higher levels. This was a major factor in meeting the accelerated reporting requirements in 2004.

2. ***Communications***. Communications during planning, execution and follow-up improved this year, but there are opportunities to improve communications among the key participants.

Planning Meetings. During the planning stage, it is important for all stakeholders who are involved in preparing and auditing the financial statements to develop a common understanding of the process, obstacles and expectations. The entrance conference, sponsored by the OIG and the public accounting firm conducting the audit, is fundamental to this process. In the past, entrance conference participants developed a common understanding of the timeline, critical dates, areas to be tested, overall audit approach and methodology as well as a discussion of any new accounting standards effective for the current fiscal year. The meeting also clarified expectations and process for participation of the Board Representatives. During the entrance conference, the participants agreed to periodic meetings with the auditors.

Best Practice: It is critical for PBGC Executives (Executive Director, Deputy Executive Director, Chief Financial Officer, Chief Operating Officer, Chief Management Officer, and Chief Technology Officer), and actuarial and financial staff to attend the entrance conference. During our sessions, there was general consensus that attendance at this meeting should be expanded to include key personnel in operations outside the CFO area. In the past, some key personnel were not invited or did not attend the entrance conference. By broadening attendance, problems encountered later in the process could have been avoided. This would facilitate better communication to key personnel on when testing will be scheduled, the impact on their operations, and schedule conflicts.

Internal Control Reviews. Another opportunity to improve communication during the planning stage is to better coordinate management's internal control efforts with auditors. Last year, PBGC undertook an initiative under the direction of the CFO to identify, document, test and report on key internal controls that is one of the first of its kind in the federal government. Auditors fully support these efforts because they demonstrate PBGC's commitment to strengthening internal controls and improving management oversight. At our sessions, auditors pointed out the value of the internal controls work by improving communications during the planning stages.

Best Practice: The auditors indicated that they could rely more on this work if:

- Internal control work followed requirements in the Financial Audit Manual published by GAO.
- Internal control work was completed by June.
- Key controls were tested on an interim basis and documentation retained.
- Controls were linked to general ledger accounts, significant transactions, and locations.

Execution. The auditors and PBGC staff have the majority of their communications during the testing and financial statement preparation phases . These communications are about operating processes, documentation, and are often data-driven. It is critical during the execution phase that these communications are timely, open, and frequent, and that all necessary offices are involved.

Best Practices. Participants in the lessons learned sessions identified a number of best practices that occurred during the execution phase of the audit that could improve our process this year. These include:

- Resolve issues earlier by auditors giving audit results to managers as soon as work is completed to facilitate a constructive dialogue.
- All affected parties, or designated alternates, attend weekly and monthly meetings.
- Provide the Management Discussion and Analysis (MD&A) and financial statements to the Executive Director and the Board Representatives for review earlier in the process.
- Strengthen the second and third quarter closes by having them mirror as closely as possible the year-end close.
- Identify items on the financial statements that can be completed on a quarterly basis and test them.
- Check progress against agreed upon milestones at monthly and weekly meetings.
- Explore opportunities to adjust the universe of companies classified as Probable and Reasonably Possible and their underfunding more often than once-a-year at year end.
- Prepare the drafts of the Legal Representation letter and Management Representation letter earlier.
- Apprise Board Representatives during 4th quarter of the status of financial statements and any significant changes.
- Auditors should request new directives both prior to audit and at the beginning of the 4th quarter
- Conduct substantive testing of the 3rd quarter.
- Minimize year end testing.

Follow-up Meetings. We also have an opportunity to improve communications after the financial audit is completed and while the Management Letter is being drafted. Most of the participants in our sessions expressed that the meetings PricewaterhouseCoopers and OIG held with each department following the issuance of the financial statement and the lessons learned meetings were beneficial and improved the relationships between the auditors and management. These meetings provided the opportunity for staff to better understand audit issues by discussing them with auditors. Auditors benefited from the meetings because they could assist managers in preparing corrective action plans and obtain feedback to improve the audit process.

Best Practice: The OIG will continue to sponsor lessons learned meetings and individual departments at the conclusion of future financial statement audits.

*3. **Better Documentation of Processes and Procedures*** Most of the recommendations for reportable conditions and management letter issues relate to documentation of processes and procedures. This has been a recurring theme of management letter reports over the years. For example:

- 16 of the 21 recommendations that address PBGC's reportable conditions are related to better documentation of processes, procedures, and decisions. (See Appendix B).
- Over 50% of the recommendations in the upcoming management letter are requesting better documentation.

Given the recent PBGC organizational changes, documenting processes, procedures, and decisions will be even more important. While some of our reportable conditions, like financial systems integration, will be a major challenge for PBGC, adopting best practices related to documentation will help correct most deficiencies currently being reported and help reduce the potential for occurrence in the future.

*4. **Early Access to 4010 Data.*** One additional issue identified in the lessons learned session was to explore the possibility of PBGC getting access to the 4010 information sooner and more often. This was also an observation that the GAO representatives made in their recent study of the pension funding rules. While it is recognized that this may require some coordination with other agencies or possibly even legislative change, this opportunity should be explored. More access to this information can provide PBGC with several benefits, e.g. the identification of potential probables.

Two Key Goals for Improving PBGC Financial Statement Reporting

There are two overarching challenges that, when addressed, the auditors believe will significantly improve PBGC's financial management and thereby the financial statement preparation – a quarterly financial close and integrated financial systems.

Quarterly Financial Close

Many private sector firms and some other government agencies close their financial books each quarter. PBGC should consider closing its financial records more frequently than once or twice a year. The CFO depends on many other departments within PBGC to perform supporting tasks, such as identifying plans that are Probable and Reasonably Possible of termination and estimating reserves for those plans, that are only done once a year. This is one of the major reasons why it is such an effort to complete the annual audit in a timely manner. All areas within PBGC that support the financial statements need to understand their critical role and be committed to make more frequent financial closings possible.

All of the participants recognize that accomplishing hard closes each quarter presents numerous challenges that will be difficult to overcome in the short run. However, establishing a long-term goal for quarterly closes that mirror the year-end process makes sense. Quarterly reporting of financial results provides better transparency and allows management and auditors to:

- Continuously check internal controls;
- Catch errors throughout the year; and
- Document processes and decisions as they occur.

The primary driver for complete financial closes each quarter, however, should be transparency. Quarterly financial reporting allows PBGC to manage its operations better based on reliable financial and performance data. This will provide timely and valuable decision-making information to all PBGC managers, not just those in the Financial Operations Department, and supports PBGC's desire to identify risk and reduce it to an acceptable level.

We are encouraged by the Executive Director's and the Chief Financial Officer's continued efforts to expand quarterly reporting. Benchmarking with other agencies within the government could help with this endeavor, along with establishing a goal for quarterly closings that include all processes used for the year-end close.

Financial Management Systems Integration

Implementing financial systems integration will significantly improve PBGC's performance in preparing its annual financial statements. This issue is a long-standing reportable condition. While it is recognized as one of the most challenging improvements for PBGC, it is also the one that offers the most promise for improving financial reporting. When implemented it should reduce the dependency on, and better control, manual inputs. This reduces the potential for errors and increases the accuracy of timely information to support all of PBGC's financial management needs, not just financial statement preparation.

APPENDIX B

REC.#	RECOMMENDATION	WHAT WAS FOUND
CTO-5	Assign specific resources to 1) update the general security plan and associated security policies to reflect the current operating environment, and 2) complete the implementation of a fully functional and integrated enterprise-wide information security program, with priority given to implementation and monitoring of technical security standards.	OIT has not developed or documented criteria/ guidance to conduct risk assessments, certifications, and accreditations.
FOD-331 FOD-333 FOD-334 FOD-335	Develop and implement a systematic methodology for validating and correcting data stored within PAS prior to the implementation of a new premium system. Develop and implement policies and procedures requiring all suspended transactions to be researched and resolved in a timely manner and ensuring that adjustments are appropriately reviewed and approved. Implement controls to reconcile Form 1 information received by PBGC to Form 550 information received by the DOL as a means of identifying plans that have not filed or paid their associated premiums Compile a comprehensive policies and procedures manual for processing and accounting for premium revenue.	PBGC has written procedures for clearing items from suspense, but there are no written policies or procedures defining monitoring controls to ensure that old items are cleared timely. PBGC does not have or maintain a complete list of plans that are required to file a Form 1 with PBGC. All of the pertinent policies and procedures related to the premium accounting cycle have not been documented, communicated or implemented throughout the Corporation.
CFND-9 CFND-10	Develop and implement internal controls to ensure the accuracy of the unfunded benefit liability calculations. The procedures implemented should ensure that documentation supporting the liability calculations is clear and readily available, and contain evidence of an independent or supervisory review. Consistently implement and enforce internal controls to ensure the completeness of the contingency listing.	Documentation utilized by PBGC to support liability calculations was not consistently maintained in accordance with OMB Circular A-123 (to be clear and readily available for review). Noted plans inappropriately excluded from the contingency list and plans inappropriately included.

CFND-12 CFND-12 CFND-13	Consistently implement procedures and guidance for documenting the decisions and judgments made to support plan classifications. Documentation should be completed in a timely manner, appropriately dated, include relevant facts and....... Consistently implement procedures to ensure that classification memos are appropriately reviewed and approved. Enhance and consistently implement guidance to fully support subsequent event determinations.....PBGC should implement policies and procedures to fully document each subsequent event, which includes the relevant facts and final judgments made by PBGC.	Documentation to support the liability calculations contained no evidence of independent or supervisory review. Memos that document PBGC's classification of a plan as probable or "high risk" reasonably possible, did not include all relevant considerations used by PBGC to make classification decisions and were inconsistently prepared. Noted instances when the "high risk" memos were not approved by the CFND Deputy Director, as required by policy guidance.
IOD-215 IOD-240	Enforce procedures requiring documentation of the reasons for additions and deletions. Amend existing documentation to require the preparer to date and sign the reconciliations. Further, update the procedures to specify the completion of an independent review of this reconciliation.	PBGC's procedures require the preparer of the reconciliation to document the reasons for deleting plans from the universe. However, formal documentation of this process, including the reasons for plan additions or deletions, was not documented. This reconciliation was not independently reviewed or validated for accuracy or completeness.
IOD-241 IOD-242	Develop and implement procedures to ensure that the MES and other data used by PBGC to classify plans includes all information available to PBGC. Develop and implement procedures to complete supervisor reviews of information and analysis performed during the initial screen of plan classifications.	Plan level information was not accurately transferred form DOL and therefore not utilized by PBGC. The information and the analysis was had not been subject to supervisory review. If the MES had been appropriately updated with

		the data available to PBGC for review, neither would have been included on the contingency list.
IOD-243 IOD-244	Document and implement a clear and consistent policy regarding the definitions and classification criteria utilized to classify plans as probable, reasonably possible or remote... Develop, and implement guidance to enhance the documentation regarding decisions and judgments made to support plan classifications. The documentation should be completed.consistent fashion...allow a third party to objectively assess..financial ratios or other financial data used..clearly and consistently documented.	The totality of criteria used to make the classification decisions by the MWG has not been fully documented. PBGC was unable to provide the documentation necessary to support the classification.