



# Pension Benefit Guaranty Corporation

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

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## MEMORANDUM REPORT

**TO:** Charles E.F. Millard  
Director

Patricia Kelly  
Chief Financial Officer

**FROM:** Luther L. Atkins *Luther Atkins*  
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**SUBJECT:** Lessons Learned from the Fiscal Year 2007  
Financial Statement Audit Process

This the fourth consecutive year that the Office of Inspector General (OIG), in cooperation with the Chief Financial Officer (CFO), has conducted a survey of the lessons learned from the annual financial statement audit. The survey consisted of the same questions as the prior year – what worked well, what did not work so well and needs improvement, and what are the key challenges that all parties will face as part of the upcoming fiscal year (FY) 2008 financial statement audit.

We are pleased to report that the Pension Benefit Guaranty Corporation (PBGC or the Corporation) continues to make significant improvements in its financial management activities, and in particular the annual financial statement audit process. In 2007, the Corporation received its fifteenth consecutive unqualified opinion on its FY 2007 financial statements, received its fourth consecutive unqualified opinion on management's assertion about the effectiveness of its internal controls, and met the government-wide financial statement audit reporting deadline of November 15. This continued success can be attributed to a strong commitment to the audit by PBGC's senior executives; department directors, managers, and staff; and PBGC's contractors; as well as a continuity of staff personnel involved in the audit on the part of PBGC, the external auditors (Clifton Gunderson), and the OIG.

We thank the CFO, the Chief Information Officer, the Contracts and Controls Review Department, Clifton Gunderson, and the other key stakeholders and their staff for their dedication in producing our fourth annual lessons learned report. We look forward to another successful financial statement audit process for FY08.

## **RESULTS IN BRIEF**

Many of the results were similar to those reported last year for the FY06 financial statement audit, but with noted significant improvement. In fact, one survey recipient characterized the audit as functioning well but needing some “minor refinements.” During the OIG’s presentation of the survey results to some of the key financial audit participants on March 27, 2008, the group concurred that this was in fact the case. The financial audit process is working very well, but can use some minor adjustments and “fine tuning.” The group also concurred that the Corporation should consider celebrating its success at the end of the annual audit by sponsoring a corporate reception.

As in FY06, most survey respondents agreed that the following worked well (or were beneficial) and should be continued for the upcoming audit:

- the regular audit status meetings, including those in separate subject matter areas, as well as the weekly prepared by client (PBC) documentation request status meetings.
- one Clifton Gunderson (CG) as point of contact for documentation requests, and in general, one Functional Area Representative (FAR) as point of contact from each major PBGC department involved in the audit.
- the Contracts and Controls Review Department’s (CCRD) coordination and facilitation of receiving and distributing documentation requests and tracking the status of prior-year audit recommendations.
- the early meetings set up by CCRD to discuss the status of prior-year significant deficiencies, the PBC list, and any other possible issues that may impact the upcoming audit.

However, in the end the strong commitment to the audit process on the part of everyone, especially the senior management, was key to the success of the process.

Areas for improvement included:

- further refinement of the audit protocol (PBC) process;
- the need for more timely auditor reviews of Recommendation Completion Forms (RCF);
- issuance and implementation of the revised audit follow-up directive;
- more timely communication of potential audit findings; and
- better communication of the newly revised internal control report structure to management.

A more detailed synopsis of some of the most common observations made in relation to areas for improvement and best practices or activities and processes that worked well are included below in the Results section of this report.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

In February 2008, the Inspector General (IG), in cooperation with the CFO, conducted a survey to identify lessons learned from the audit of the FY07 financial statements, so that the results could be potentially incorporated into the FY08 financial statement audit process. We surveyed PBGC employees who were considered key stakeholders, and those who were involved in the financial statement audit process. The survey participants were asked to provide feedback on:

- Areas, activities, and processes that worked well and were successful;
- Areas, activities, and processes that could be improved upon or added for FY 2008;
- Audit status meetings and audit protocol (PBC) meetings;
- Performance of the auditors, PBGC management, contractors, and external third parties (i.e., Government Accountability Office); and
- Potential challenges that could impact the FY 2008 audit.

The OIG also sent the survey to Clifton Gunderson - the external financial statement auditors - and PBGC contractors and their Contracting Officer's Technical Representatives (COTRs), as appropriate.

The OIG sent the survey to 61 individuals, of which 13 responded. In some cases, PBGC management sent a combined response on behalf of a department or a number of individuals.

Once the OIG received and compiled the survey responses, the OIG held a meeting on March 27, 2008, to discuss the survey results. The meeting included the key stakeholders, such as senior executives, department directors, OIG staff, and the CG partners.

## **RESULTS**

The financial audit is a significant effort across the Corporation that consumes numerous labor hours on the part of the auditors, PBGC management, PBGC staff and contractors. Furthermore, it takes the commitment on the part of everyone in order to complete the audit and issue the required final audit opinions, together with the financial statements, by the Office of Management and Budget (OMB)-mandated November 15 deadline – only 45 calendar days after the fiscal year-end. In fact, the draft report must be submitted to OMB by November 1 – only one month after the fiscal year-end. Subsequent to this deadline, the auditors must issue another special purpose audit opinion on selected data from the financial statements that must be submitted to OMB, the Government Accountability Office (GAO) and the United States Treasury for use in the government-wide consolidated financial statements, only two days later.

From April through November of each year, PBGC management and staff must complete all of its work related to implementation of adequate internal controls and preparation of the financial statements, as well as respond to auditor requests for time and documentation, in addition to performing their normal day-to-day duties. Given that PBGC, the OIG and

the external auditors have been able to work together so well to meet the deadlines, and PBGC has been able to receive an unqualified opinion on its financial statements for 15 consecutive years, it makes sense that everyone should celebrate this continued success. Therefore, survey respondents recommended that PBGC management sponsor an event to celebrate the success of the financial statement audit process and the persons involved in the process.

Areas, activities, or processes that survey respondents said **worked well** included:

- Regular audit status meetings
- Separate OIT and financial audit protocol/PBC meetings to discuss the status of documentation requests on a weekly basis
- Designated Functional Area Representative (FARs) for each key audit area
- PBGC audit protocol process, facilitated by CCRD
- Tracking of new and prior audit recommendations
- Improved contractor site visits
- Strong management commitment to the audit process
- Early CG/OIG/FAR meetings to discuss the status and progress of prior audit recommendations, primarily related to the significant deficiencies
- Early and continued briefings by the auditors (OIG and CG) to PBGC management regarding the change in reporting on internal control (*Statement on Auditing Standard (SAS) 112* and significant deficiencies)
- Details of the significant deficiencies issued in a separate, limited disclosure report
- CG audit staff continuity and decreased learning curve
- Issuance of Notices of Findings and Recommendations (NFR)
- Use of PBGC's imaging system (IPS) to work from remote locations

Areas, activities, or processes that **require improvement** included:

- More timely OIG/CG analysis of RCF packages and communication of test results to management in relation to outstanding audit recommendations
- More refinement of the audit protocol process, including the PBC list
- More timely communication of potential audit findings and possible adjustments (to financial statements) to PBGC management
- Issuance and implementation of the revised audit follow-up directive
- Better communication and clarification to management regarding the newly revised internal control report structure

Some **key challenges** that could impact the FY08 audit included:

- Restructuring and award of new Field Benefit Administrator (FBA) contracts mid-year
- Award of a significant OIT contract
- Continued implementation of the Pension Protection Act of 2006, and development of a new premiums system (PPS)
- The impact of new accounting and auditing standards

### ***What worked well and should be continued for FY08***

The majority of the survey participants stated that the following worked well and should be continued during the FY08 audit:

- *Strong Commitment to the Audit Process* – To meet OMB’s November 15 deadline to submit the AMR, a strong commitment to the audit process is crucial. For the FY07 audit, there was a strong commitment on the part of the Senior Executives and Department Directors to facilitate the audit process and cooperate with the Financial Operations Department (FOD), CCRD, and the auditors. PBGC management communicated their commitment to their staff and contractors at all levels and enforced this commitment, whenever necessary. This in turn helped the OIG and the CG staff to complete their audit work on-time.
- *Early and Ongoing Communication of New Internal Control Reporting Requirements (SAS 112)* – Changes in the auditing standards related to the auditors’ required communication of internal control matters to PBGC management and its Board of Directors became effective for the FY 2007 audit process. This new auditing standard reclassified the term “reportable condition” to “significant deficiency,” and lowered the threshold for reporting internal control deficiencies. As a result, in this year’s internal control opinion, several management letter items now culminated into a more comprehensive significant deficiency.

At the onset of the audit and throughout the audit, the OIG, CG, and CCRD gave presentations on the new standard to PBGC’s senior staff, Advisory Committee members and Board representatives, and PBGC staff. In addition, during the audit status meetings, as well as other meetings, the auditors continued to remind PBGC management of the significance and impact of the new auditing standard. Although the standard allows for auditor judgment, CG tried to remain transparent and open in its discussions with management regarding their decision-making process in determining whether and how they reported items as management letter issues or significant deficiencies, and how they regrouped and/or closed prior-year audit recommendations.

The survey respondents appreciated the OIG and CG’s efforts to communicate and educate management and staff regarding the new requirements. In addition, they appreciated CG’s candor in explaining how and why they reported the items, even if management did not always agree. Finally, management was pleased that CG and the OIG closed and “reissued” several of the prior-year audit recommendations into more meaningful, systemic internal control issues and recommendations.

- *Periodic audit status meetings* – Survey participants thought that these meetings, which became more frequent as the due date for PBGC’s Annual Management Report (AMR) approached, were both an efficient and effective means of ongoing communications between and among PBGC management, the OIG and CG. They felt that these meetings should continue for the FY08 audit.

- *Weekly audit protocol (PBC) meetings, the audit protocol process, and CCRD's involvement* – CCRD held separate OIT and “other” financial audit meetings to discuss the status of audit documentation requests from both PBGC and the auditors. Everyone agreed that these meetings should continue for FY08 and remain separate (OIT and other), given the nature and number of requests to be discussed during the meetings. Everyone applauded CCRD's efforts in coordinating, facilitating, and performing the preparation for these meetings, as well as CCRD's tracking of prior and new audit recommendations in its custom-made database. During the FY07 audit, CCRD developed several new reports to assist management and the auditors in tracking progress and the status of these audit recommendations. This database should also assist management and the auditors as part of the audit follow-up process.
- *Contractor Site Visit* - For one of the auditor's IT site visits during the FY06 audit, both CG auditors and contractor personnel indicated that communications and cooperation with respect to documentation requests needed further improvement. During the FY06 audit, the relations between the auditors and the contractor (and its subcontractor) were quite strained and resulted in the auditors not receiving several of its requested items and having to sign a non-disclosure agreement at the last minute. However, for the FY07 audit, the auditors, PBGC, and the contractor had several meetings and conference calls to discuss PBC requests and testing prior to the auditors visiting the contractor site. While onsite, the PBGC COTR and management representative greatly helped to facilitate the request and receipt of PBC items. In fact, this year CG was able to speak directly with and request items directly from the subcontractor's management and staff, without difficulty. Although there remained some resistance from contractor personnel in providing requested items to CG, as well as some misunderstandings as to what was being requested, the improvement in this area was tremendous. For the FY08 audit, PBGC management and the COTR plan to visit the contractor at the beginning of the audit and work with CG to provide an updated PBC listing to the contractor personnel far in advance of the auditors' site visit.
- *Functional Area Representatives* – At the beginning of the audit, management designated FARs for each of the key areas having an impact on the financial statements and the audit of these statements. The FARs met periodically with CCRD and the auditors, as part of the audit protocol process, which helped to facilitate the coordination of documentation requests, meetings between the auditors and PBGC staff and management, and the notification of potential audit findings. This continued to work well during the FY07 audit. In addition, the auditors, the FARs, and CCRD met at the beginning of the audit to discuss the status and progress of the prior-year audit recommendations, especially those related to the prior reportable conditions. There are plans to continue these initial and ongoing meetings between the auditors and PBGC for the FY08 audit.
- *Changes in Audit Report Format* – For FY07 reporting, CG issued one combined audit report, rather than three separate reports and opinions on the financial statements,

internal control, and compliance with applicable laws and regulations. With respect to the report on internal control, the OIG and CG decided to issue the required report on internal control within the combined audit report, and a separate limited disclosure report, which included the details of each of the three significant deficiencies. Distribution of the latter report was limited to the OIG, PBGC management, and its Board of Directors and therefore was not published on the OIG website. The survey respondents felt that this worked well, and the appropriate level of information was conveyed to the intended audiences.

Other positive items noted included:

- CG audit staff continuity and decreased learning curve
- Open communication between CG's actuaries and PBGC, and their informal sharing of areas for improvement with management
- Professionalism, efficiency, responsiveness and availability of the CG and OIG staff
- Issuance of NFRs
- Good cooperation between the Office of the General Counsel and the Office of the Chief Counsel in preparing and submitting consolidated legal representation letters in a timely manner
- Ability of CG staff and contractors (actuaries) to use IPS to review documents prior to interviews and as a part of testing, thus saving PBGC staff time and paper (making photocopies)

### ***What could be improved upon or added for FY08***

The following are the key areas for improvement identified in the survey, as well as some of the suggested recommendations for the upcoming financial statement audit.

- *Audit Protocol (PBC) Process* – Although implementation of the audit protocol process was a positive initiative, there is still room for minor refinements. The communication lines between the auditors and management can be more open. Also, survey respondents stated that the PBC list should be revisited at the beginning of the audit and “cleaned up.” Both auditors and PBGC agree that the list has some duplication, and the document request descriptions can not always be understood by both the requestors and the providers of the information. In addition, there was a request that the list be sorted by business cycle and division, to further facilitate the process. Similar to last year, there were still some cases where the auditors and PBGC management and staff communicated directly and did not always inform CCRD that documents had been requested or provided. Furthermore, some of the providers of requested information and documentation on the PBC list did not meet some of the deadlines and also did not request an extension in a timely manner (prior to missing the deadline). Finally, the auditors noted that, on several occasions, once they received the PBC items they were still incomplete or were not what had been requested.

- *Timely Auditor Review of Recommendation Completion Forms and Communication of Results of Testing* – The OIG/CG analysis of the Recommendation Completion Form (RCF) was not always timely according to management. Management would prefer hearing as soon as possible and hopefully during the audit period that a recommendation was not going to be closed so that additional remedial actions can be taken. For example, management contends that items completed in the earlier part of the fiscal year were not reviewed until much later in the audit cycle or even beyond the fiscal year end. Management would prefer that certain recommendations be tested earlier as part of internal control testing and not as a part of substantive testing. In some cases, CG informed management that an RCF was rejected and the related recommendation was not closed. However, CCRD stated that it did not know the reason for keeping the recommendation open and therefore could not update its audit recommendation database. Further, open communications between and among PBGC management and CCRD and CG, as well as issuance and implementation of the revised audit follow-up directive should help to improve this process.
- *Notification of Potential Findings, including Possible Audit Adjustments (to financial statements)* - Many stated that the use of CG’s Notice of Findings and Recommendations (NFR) forms was positive; however, management would prefer to receive feedback regarding potential findings in a more timely manner. In general, an NFR form is signed by the PBGC person directly involved in the particular process or control activity. This form is also signed by the applicable department director and/or senior executive to help ensure that persons at all levels are informed of the issue when it is raised. Although this process worked well, PBGC management stated that they would like to see interim or draft NFRs, so that they can quickly identify and address any potentially high-risk items. In turn, the auditors would like to receive a more timely response regarding the issues raised.

Also during the FY07 audit, various individuals posed some questions to the auditors related to the possible need to reclassify or make adjustments to some material financial statement component amounts, including note disclosures. Even though in the end, CG determined that no material adjustments or reclassifications were required, they did not raise the possibility of such a significant issue at the regular audit status meetings or make a decision regarding the issue until close to the audit report due date. Some survey recipients stated that consideration of such a significant item should at least be mentioned during the audit status meetings, included in the audit status report, and a final decision (along with the reasoning behind the decision) regarding the item be communicated to management and the persons raising the issue. This would provide for better transparency during the process.

- *Better Communication of the Revised Internal Control Report Structure* – As mentioned above, CG and the OIG closed and “reissued” several of the prior-year audit recommendations into more meaningful, systemic internal control issues and recommendations. In addition, CG combined the audit opinion on the financial statements, internal control report, and the report on compliance with laws and regulations into one report. Further, the auditors issued the details related to the

internal control portion of the report as a separate, limited disclosure report that was not published on the OIG website. The OIG and CG decided to make many of these changes during the end of the audit. Although the auditors included explanations and a crosswalk of the prior audit recommendations to the new ones in the audit reports, some survey respondents still experienced some confusion. Also, some respondents stated that they did not fully understand the reasoning behind the limited disclosure report, given that the items in the report were not considered by them to be sensitive. Finally, some survey respondents stated that they would like to have a discussion regarding the differences between material weaknesses, significant deficiencies, and management letter items and whether the classification is solely based on auditor judgment or can be measured based on certain criteria. For FY08, the auditors can hold further discussions with PBGC management regarding these items, to provide more clarification.

Other items noted for improvement included:

- Finalizing the format and content of the management representation letter earlier in the audit;
- Issuance of the revised audit follow-up directive and its implementation;
- Earlier issuance of the management letter

***Potential challenges for the FY08 audit***

Some of the potential challenges identified that could have an impact on the FY08 audit include:

- Changes and updates to the auditing and accounting standards (FASB and FASAB standards)
- Award of the new FBA contracts
- Award of a new substantial OIT contract, as well as the realignment of the OIT organization
- Development of a new premiums system (PPS)
- Continued implementation of the Pension Protection Act of 2006

## **CONCLUDING REMARKS**

The OIG is committed to working with and supporting the CFO, Chief Information Officer, CCRD, CG, and the other PBGC senior executives, management, and staff who will be involved in the upcoming financial statement audit. We look forward to another successful financial statement audit process for FY08.

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