Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Fiscal Year 2001
Financial Statement Audit –
Management Letter

August 29, 2002

2002-6/23157-5

Fiscal Year 2001 Financial Statement Audit
Management Letter Report

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TABLE OF CONTENTS

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act
FBA	Field Benefit Administrator
FY	Fiscal Year
GAB	General Accounting Branch
IOD	Insurance Operations Department
IPVFB	Integrated Present Value of Future Benefits
IRMD	Information Resources Management Department
IPS	Image Processing System
NIST	National Institute of Standards and Technology
NRFFA	Non-recoverable Future Financial Assistance
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAS	Premium Accounting System
PBGC	Pension Benefit Guaranty Corporation
PRISM	Participant Records Information Systems Management
PVFB	Present Value Future Benefits
RA	Reconciliation Administrator
SDLC	Systems Development Life Cycle
SOA	Statement of Accounts
SOR	Significant Occurrences Report
SSB	State Street Bank
TP	Technical Procedure

Fiscal Year 2001 Financial Statement Audit
Management Letter Report
Audit Report Number 2002-6/23157-5

EXECUTIVE SUMMARY

The Office of Inspector General (OIG) of the Pension Benefit Guaranty Corporation (PBGC or the Corporation) engaged PricewaterhouseCoopers LLP (PricewaterhouseCoopers) to conduct an audit of the financial statements of the Single-Employer Program and Multiemployer Program Funds administered by PBGC, as of and for the years ended September 30, 2001 and September 30, 2000. Our audits were performed in accordance with standards established by the American Institute of Certified Public Accountants (AICPA) in the United States of America, *Government Auditing Standards,* and pursuant to the methodology set forth by the United States General Accounting Office's (GAO) *Financial Audit Manual* (FAM). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

As a result of our FY 2001 audit, we issued the following reports:

- an unqualified opinion on PBGC's statements of financial condition, and the related statements of operations and changes in net position and statements of cash flows, as of and for the years ended September 30, 2001, and September 30, 2000 (OIG report number 2002-3/23157-2);
- a report on PBGC's compliance with laws and regulations that noted no instances of non-compliance with the provisions tested (OIG report number 2002-3/23157-2); and
- a report on internal control that identified three recurring reportable conditions (OIG report number 2002-3/23157-2). These reportable conditions were not deemed to be material weaknesses as defined by standards established by the AICPA in the United States of America.

Our FY 2001 report on internal control included two reportable conditions that were carried forward from FY 2000. Additionally, this reportable condition was reported in FYs 1996 through 1999. The first reportable condition related to the lack of integration of the Corporation's financial management systems, including the need for an adequate Systems Development Life Cycle (SDLC) methodology and the need for adequate systems development monitoring and oversight of third party contractors employed by PBGC. During FY 2001, we noted PBGC successfully completed developing and documenting major portions of the SDLC methodology. However, additional work is required to integrate PBGC's financial management systems, implement the formal SDLC corporate-wide, and identify, document and follow specific criteria to allow the Corporation to effectively monitor systems outsourcing.

The second reportable condition that was carried forward from FY 2000 related to the need to further develop, implement and test an adequate plan for maintaining continuity of operations. Additionally, this reportable condition was reported in FYs 1999 and 1998. During FY 2001, PBGC made notable progress by improving its disaster recovery and business continuity plans. However, our FY 2001 audit still identified a number of deficiencies that would impair PBGC's ability to respond effectively to a disruption in business operations.

In addition to the reportable conditions specified above, we identified a number of internal control weaknesses that, although not considered material weaknesses or reportable conditions, we believe warrant the attention of management. Specifically, in FY 2001, we downgraded the third reportable condition on the need to implement and improve controls surrounding the Participant Records Information Systems Management (PRISM) from the FY 2000 internal control report to a management letter finding in FY 2001. Although PBGC made substantial improvement in designing and implementing control procedures related to PRISM operations, further strengthening of controls is needed.

This management report presents 16 findings with 24 recommendations for improvements in the Corporation's internal control that were identified during our audit of the FY 2001 financial statements.

Findings	Summary of Recommendations	Page
1	*Develop a system to specifically identify limitation administrative expenses and develop fiscal year budgets using the specific identification methods. (BD-2)*	7
1	*Provide documentation to support the accuracy of the allocation ratio and the propriety of designating administrative expenses as not being subject to limitation as defined in the appropriation law. (BD-3)*	7
2.1	*Enforce PRISM Trial Balance Reconciliation review procedures in TP 11.1. (IOD-202)*	9
2.1	*Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to establish a timetable to review variances in the PRISM Trial Balance Reconciliation. (IOD-203)*	9
2.1	*Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to require that the reconciliations be imaged in IPS after supervisory review. (IOD-204)*	9
2.2	*Document a review procedure of PRISM Balancer Module reconciliations and unify the reconciliation documentation requirements by defining which print screens to keep as evidence of final resolution of the discrepancy, and what areas need to be completed in the summary sheets for management review. (IOD-205)*	10
2.2	*Establish monitoring criteria for PRISM Balancer Reconciliatons by defining the types of discrepancies that should be "flagged" by the staff and brought to management's attention for follow-up action. (IOD-206)*	10
2.3	*Amend TP 30.1 to include deadlines for completion of the monthly reconciliations and to require supervisory review and approval. (IOD-207)*	10
3	*Implement monthly procedures to submit a list of inactive participants to the PRISM team before the month-end cut-off to update the pay status to inactive and to verify that the submitted changes were made (IOD-208)*	11
4	*Modify TP 12.7 and 12.8 to require that the audit working papers be imaged, including the sample selected, the database associated with the sample, all sources used to test the sample and the errors found in the sample. (IOD-209)*	12

Findings	Summary of Recommendations	Page
5.1	*Strengthen compliance with premium refund timeliness goals. (FOD-289)*	12
5.2	*Adopt a methodology for the premiums receivable allowance calculation and apply it consistently each year. (FOD-290)*	13
6.1	*Develop and document specific policies and procedures to perform risk assessments of business systems as required by OMB. (CTO-1)*	14
6.1	*Implement the established policies and procedures for completing risk assessments to comply with OMB requirements. (CTO-2)*	14
6.2	*Improve the information security structure to provide for enhanced responsibility and accountability. (IRMD-131)*	15
6.3	*Develop and document policies and procedures for the performance of periodic recertifications of PBGC systems' user accounts. (IRMD-132)*	16
6.3	*Implement periodic re-certifications of PBGC systems' user accounts. (IRMD-133)*	16
6.4	*Establish monitoring procedures to enforce compliance with existing change control policies, procedures, and standards. (IRMD-134)*	17
7.1	*For cases with data sources more than five years old, implement a procedure to determine whether 1) an updated data source would provide a more accurate estimate of the NRFFA liability and 2) a valuation is available or can be completed without a significant burden on resources. (IOD-210)*	17
7.2	*Revise the Controller Division Consolidated Procedures Manual to require that the promissory notes and financial assistance disbursement documents are timely placed in the General Accounting Branch vault, and sign-out logs are periodically reviewed to ensure documents are returned timely. (FOD-291)*	18
8.1	*Provide the appropriate training to PBGC management and employees to understand derivatives transactions, account for them properly, and disclose them properly in the financial statements. (FOD-292)*	19
8.1	*Actively monitor derivatives activity by monitoring SSB's accounting and reporting activities. (FOD-293)*	19
8.1	*Reconcile SSB and the investment managers' derivative inventories and positions monthly. (FOD-294)*	19
8.2	*PBGC's Board of directors should review and approve PBGC's investment policy once every two years. (FOD-295)*	20

MANAGEMENT RESPONSE AND OIG EVALUATION

PBGC management was provided a draft copy of this report for review and comment. In addition, we met with PBGC officials to discuss the findings and recommendations. After these discussions, the OIG removed one finding from the draft report relating to lack of a formal investment strategy. With respect to the formal investment strategy, PBGC management provided additional data showing that a investment strategy is in place.

We have reviewed PBGC's comments to this Report. PBGC management commented on and agreed with the findings and recommendations in this final report. Their comments can be found at Tab A.

Fiscal Year 2001 Financial Statement Audit
Management Letter Report

Audit Report (2002-6/23157-5)

Introduction

As a government corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, the Pension Benefit Guaranty Corporation (PBGC or the Corporation) protects the pensions of more than 44 million Americans in approximately 35,000 private defined benefit pension plans, including about 1,700 multiemployer plans. PBGC's mission is to operate as a service-oriented, professionally managed agency that protects participants' benefits and supports a healthy retirement plan system by: (1) encouraging the continuation and maintenance of private pension plans for the benefit of their participants; (2) providing timely payments of benefits in the case of terminated pension plans; and (3) making the maximum use of resources and maintaining premiums and operating costs at the lowest levels consistent with statutory responsibilities. PBGC 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.

Audit Objectives

The objectives of our audit were to determine whether:

- The financial statements present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2001, and September 30, 2000, 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.
- Management's assertion that PBGC's management controls in effect as of September 30, 2001, provided reasonable assurance that assets were safeguarded from material loss and transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, PBGC 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). This assertion is included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of PBGC's Fiscal Year (FY) 2001 Annual Report to the Congress.
- PBGC is in compliance with significant provisions of applicable laws and regulations.

Scope and Methodology

The Office of Inspector General (OIG) of PBGC engaged PricewaterhouseCoopers LLP to conduct an audit of the financial statements of the Single-Employer Program and Multiemployer Program Funds administered by PBGC as of and for the years ended September 30, 2001, and September 30, 2000.

Our audits were performed in accordance with standards established by the American Institute of Certified Public Accountants (AICPA) in the United States of America, *Government Auditing Standards,* and pursuant to the methodology set forth by the United States General Accounting Office's (GAO) *Financial Audit Manual* (FAM). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

We performed tests of the accounting records and such other auditing procedures, as we considered necessary in the circumstances. This involved performing tests at PBGC, State Street Bank (SSB), two investment manager sites, and two Field Benefit Administrator (FBA) sites. We did not perform tests related to standard terminations or other areas since such events did not have a direct and material effect on the financial statements.

Audit Results

As a result of our FY 2001 audit, we issued the following reports:

1. An unqualified opinion on PBGC's statements of financial condition, and the related statements of operations and changes in net position and statements of cash flows, as of and for the years ended September 30, 2001, and September 30, 2000 (OIG Report 2002-3/23157-2);
2. A report on PBGC's compliance with laws and regulations that noted no instances of non-compliance with the provisions tested (OIG Report 2002-3/23157-2); and
3. A report on internal control that identified two recurring reportable conditions (OIG Report 2002-3/23157-2). These reportable conditions were not deemed to be material weaknesses as defined by standards established by AICPA in the United States of America.

Our FY 2001 report on internal control included two reportable conditions that were carried forward from FY 2000. Additionally, this reportable condition was reported in FYs 1996 through 1999. The first reportable condition related to the lack of integration of the Corporation's financial management systems, including the need for an adequate Systems Development Life Cycle (SDLC) methodology and the need for adequate systems development monitoring and oversight of third party contractors employed by PBGC. During FY 2001, we noted PBGC successfully completed developing and documenting major portions of the SDLC methodology. However, additional work is required to integrate PBGC's financial management systems, implement the formal SDLC corporate-wide, and identify, document and follow specific criteria to allow the Corporation to effectively monitor systems outsourcing.

The second reportable condition that was carried forward from FY 2000 related to the need to further develop, implement and test an adequate plan for maintaining continuity of operations. Additionally, this reportable condition was reported in FYs 1999 and 1998. During FY 2001, PBGC made notable progress by improving its disaster recovery and business continuity plans. However, our FY 2001 audit still identified a number of deficiencies that would impair PBGC's ability to respond effectively to a disruption in business operations.

In addition to the reportable conditions specified above, we identified a number of internal control weaknesses that, although not considered material weaknesses or reportable conditions, we believe warrant the attention of management. Specifically, in FY 2001, we downgraded the third reportable condition on the need to implement and improve controls surrounding the Participant Records Information Systems Management (PRISM) from the FY 2000 internal control report to a management letter finding in FY 2001. Although PBGC made substantial improvement in designing and implementing control procedures related to PRISM operations, further strengthening of controls is needed. Specifically, PBGC needs to address or complete the following recommendations that have in the past supported the PRISM reportable condition and still remain open as a result of FY 2001 audit work:

- Perform an analysis of data integrity within the PRISM database and develop a formal corrective action plan; **(OIG Control Number IOD-151)**
- Analyze and improve system edits and processing controls within PRISM to minimize erroneous data input and data processing. Design and place in operation an exception reporting mechanism to mitigate the risk of unauthorized transactions processing; **(OIG Control Number IOD-152)**
- Enforce existing IOD policies and procedures requiring that participants' files contain complete information critical for the benefit payments and the PVFB liability calculation; **(OIG Control Number IOD-169)**
- Enforce policies and procedures that require participants' records in PRISM contain information that is adequately supported in IPS; **(OIG Control Number IOD-172)**
- Delete invalid duplicate participant records in PRISM and implement necessary controls to prevent the creation of duplicate records in future processing; **(OIG Control Number IOD-175)**
- 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)**
- 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; **(OIG Control Number IOD-195)**
- Changes made by the Data Working Group should be sent back for re-authorization; **(OIG Control Number IOD-196)**
- 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; and **(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)**

Findings and Recommendations

This report contains **16** findings, resulting in **24** recommendations that PBGC should implement to strengthen the Corporation's internal control. The remainder of this report is comprised of the following:

- A table listing our current year recommendations (pages 5-6).
- A discussion of each current year finding and corresponding recommendation(s) (pages 7-20).

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1	*Provide documentation to support the accuracy of the allocation ratio and the propriety of designating administrative expenses as not being subject to limitation as defined in the appropriation law. (BD-3)*	7
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6.1	*Implement the established policies and procedures for completing risk assessments to comply with OMB requirements. (CTO-2)*	14
6.2	*Improve the information security structure to provide for enhanced responsibility and accountability. (IRMD-131)*	15
6.3	*Develop and document policies and procedures for the performance of periodic recertifications of PBGC systems' user accounts. (IRMD-132)*	16
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7.2	*Revise the Controller Division Consolidated Procedures Manual to require that the promissory notes and financial assistance disbursement documents are timely placed in the General Accounting Branch vault, and sign-out logs are periodically reviewed to ensure documents are returned timely. (FOD-291)*	18
8.1	*Provide the appropriate training to PBGC management and employees to understand derivatives transactions, account for them properly, and disclose them properly in the financial statements. (FOD-292)*	19
8.1	*Actively monitor derivatives activity by monitoring SSB's accounting and reporting activities. (FOD-293)*	19
8.1	*Reconcile SSB and the investment managers' derivative inventories and positions monthly. (FOD-294)*	19
8.2	*PBGC's Board of directors should review and approve PBGC's investment policy once every two years. (FOD-295)*	20

1. Classification of administrative expenses not properly supported.

In the Consolidated Appropriations-2001 Act (Public Law 106-554), PBGC was required to limit administrative expenses in FY 2001 to $11,652,000. This law does not define what types of expenses are considered administrative and therefore subject to limitation. It does, however, identify the types of expenses that are "considered as non-administrative expenses for the purposes hereof, and excluded from the above limitation." These excluded expenses, referred to as "non-limitation," are defined as expenses relating to:

- Termination of pension plans;
- Acquisition, protection, management or investment of trust assets; and
- Benefits administration services.

In FY 2001, PBGC budgeted $41 million in administrative (limitation) expenses and $147 million in non-limitation expenses. In order to meet the Congressional cap on limitation expenses, PBGC applied a ratio to allocate a portion of the $41 million to non-limitation expenses. During our FY 2001 testing, we noted no documented support that the amounts allocated to non-limitation expenses through application of this ratio met the definition of non-limitation expenses.

The policies related to the Corporation's determination of which administrative expenses are limitation or non-limitation expenses may be improper or inadequate. If reviewed on an individual expense basis, the cumulative total of these administrative expenses may exceed Congressional limitation.

Recommendations

We recommend the following corrective actions:

> *Develop a system to specifically identify limitation administrative expenses and develop fiscal year budgets using the specific identification methods. (BD-2)*
>
> *Provide documentation to support the accuracy of the allocation ratio and the propriety of designating administrative expenses as not being subject to limitation as defined in the appropriation law. (BD-3)*

2. PRISM Reconciliations Need Improvement.

PRISM is an integrated information system developed to support PBGC in administering pension plan customers. PRISM also provides an automated interface with State Street Bank for benefit payment information. In our testing of PRISM, we noted several instances in which required reconciliations were not performed timely, evidence to support reconciliation of the variance was not maintained, and supervisory review was not documented.

2.1 PRISM Trial Balance Reconciliation not properly maintained and reviewed.

State Street Bank (SSB) is PBGC's paying agent for benefit payments to participants. Before the payments (checks and automatic deposits) are released by SSB, the PRISM Trial Balance Reconciliation (Trial Balancer) module compares the authorized benefit payment information PBGC provides to SSB with the payment file created by SSB to identify discrepancies. During our FY 2001 testing of the PRISM Trial Balancer process, we noted that the Reconciliation Administrator (RA) is not properly maintaining supporting documentation, including e-mail messages sent out by the Information Resources Management Department (IRMD) for each variance noted during the reconciliation process. We also noted that the RA is not timely reviewing and processing the resolutions.

Per PBGC Technical Procedure (TP) 11.1, the RA is responsible for:

- maintaining records of e-mails sent out by IRMD regarding the variances for tracking purposes;
- maintaining the "Reconcile Screen" for variances and updating it with the error correction and variance resolution codes upon receipt of the completed Trial Balance Variance Reports from the Trusteeship Processing Divisions (TPDs)/Field Benefit Administrators (FBAs); and
- sending completed Trial Balance Variance Reports and any attachments to the Document Management Center for imaging to the payee's files in the Image Processing System (IPS) after entering the resolution codes in PRISM Trial Balance.

The RA stated that it is impractical to maintain the e-mail messages sent out by the IRMD due to computer storage space limitations. In addition, the RA stated that time limitations have prevented him from reviewing the resolutions, updating the resolution codes on the Variance Report, and sending the reports to be imaged in IPS.

The RA should analyze the summary Trial Balancer report, identify critical errors that are high priority and immediately take corrective action. This will allow PBGC to take full advantage of the Trial Balancer capabilities to catch and correct errors before checks are issued, thus preventing after-the-fact recoupment efforts. Failure to adhere to processing and review procedures is a control weakness and can hinder the efficiency and effectiveness of management operations and review processes.

Recommendations

We recommend the following corrective actions:

Enforce PRISM Trial Balance Reconciliation review procedures in TP 11.1. (IOD-202)

Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to establish a timetable to review variances in the PRISM Trial Balance Reconciliation. (IOD-203)

Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to require that the reconciliations be imaged in IPS after supervisory review. (IOD-204)

2.2 Lack of management review procedures regarding Balancer Module Reconciliation.

Each month after PBGC transfers the payment file to SSB and checks are issued, the PRISM Balancer Module automatically generates an exception report that lists discrepancies between PBGC's authorized and SSB's actual benefit payment amounts. The discrepancies are then assigned to PBGC staff to investigate. During our FY 2001 testing of PRISM Balancer Module reconciliations, we noted inconsistencies among the staff in maintaining the supporting documentation for management review. Specifically, some summary sheets did not have evidence of reviewer sign-off and some did not have "corrective action taken" boxes checked off. Furthermore, some supporting documentation did not include the final resolution of the issue, yet was marked reviewed by the supervisor. If the supervisor reviewed the final resolution electronically, it was not noted in the documentation.

Inconsistencies in and incompleteness of the PRISM Balancer Module reconciliation were a direct result of a lack of step-by-step management review procedures. Currently PBGC's Insurance Operations Department (IOD) on-line procedures manual contains a procedure on resolving payment variances (TP 09.1) but does not establish management review procedures. Enhanced procedures will improve the efficiency and effectiveness of the management review process.

Lack of sound management review procedures defining the necessary supporting documentation to maintain and what areas in the summary sheet need to be completed before the reconciliations can be passed on for management review is a control weakness and can hinder the efficiency and effectiveness of the management review process.

Recommendations

We recommend the following corrective actions:

> *Document a review procedure of PRISM Balancer Module reconciliations and unify the reconciliation documentation requirements by defining which print screens to keep as evidence of final resolution of the discrepancy, and what areas need to be completed in the summary sheets for management review. (IOD-205)*
>
> *Establish monitoring criteria for PRISM Balancer Reconciliations by defining the types of discrepancies that should be "flagged" by the staff and brought to management's attention for follow-up action. (IOD-206)*

2.3 Reconciliations of benefit payments to funding requests not performed timely or reviewed.

During our FY 2001 control testing related to accounting for benefit payments, we noted that reconciliations between benefit funding requests, prepared by PBGC and submitted to SSB, and actual benefits paid by SSB were not performed timely. Each of the twelve monthly reconciliations tested was performed from one month up to six months after the date of the funding approval memorandum. In addition, none of the monthly reconciliations showed evidence of review and approval by an IOD supervisor.

PBGC TP 30, *Reconcile Funding to SSB with Actual Payments,* requires that the Technical Support Division Funding Reconciliation Administrator review the benefit funding documents sent by SSB to ensure the figures agree with the funding request, and then reconcile the figures with PRISM payment ledgers. However, TP 30 does not specify timeliness or require supervisory review and approval. If reconciliations of benefit funding requests to actual benefits paid are not performed and reviewed in a timely manner, differences may not be detected.

Recommendation

We recommend the following corrective action:

> *Amend TP 30.1 to include deadlines for completion of the monthly reconciliations and to require supervisory review and approval. (IOD-207)*

3. Participants with incorrect pay status in PRISM.

During our FY 2001 testing at the Iowa and Wisconsin FBA sites, we noted that for 13 out of 45 participants tested at the Iowa site and one out of 45 tested at the Wisconsin site, the pay status was incorrect. These participants had received a one-time lump-sum benefit payment and were not entitled to receive additional payments. However, PRISM continued to show their pay status as "active."

The pay status change from "active" to "inactive" within PRISM is partially automatic in that if the payment amount is within five percent of the lump sum discriminator, preset by the system in accordance with the plan actuarial valuation, the participant's status will be changed to "inactive." If the payment amount is outside of the five percent threshold, then the status change has to be manually updated by the PRISM team. The IOD procedures do not define who is responsible for initiating and reviewing the manual changes from "active" to "inactive" pay status.

Although there are no future payments set up in the system, leaving the participants in an active pay status may affect the Present Value Future Benefits (PVFB) actuarial calculations. The PVFB is calculated for all participants in an active pay status and even though the actuaries generate exception reports prior to calculating PVFB, improper inclusion in the PVFB calculation may still occur.

Recommendation

We recommend the following corrective action:

> *Implement monthly procedures to submit a list of inactive participants to the PRISM team before the month-end cut-off to update the pay status to inactive and to verify that the submitted changes were made. (IOD-208)*

4. Participant data audits not properly supported and reviewed.

Audits of the completeness and accuracy of participant data (participant data audits) are primarily performed by the Corporation to provide its actuaries with the information necessary to efficiently and accurately complete the plan valuations and to determine which plan participants are eligible for benefits. During our FY 2001 testing of the participant data audits, we noted that the audit procedures performed and source documents examined were not clearly described or maintained in the audit reports reviewed.

In accordance with the IOD TP 12.7, "all source documents traced to during the testing of the database must be copied and placed in the audit work papers to support the confidence level certified by the auditor or reviewer." In addition, TP 12.8 specifically describes the auditing procedures, sampling methodologies, and error classification methodologies to be followed.

If the participant data audit reports are not in compliance with IOD TPs 12.7 and 12.8, it is difficult for management to review the work performed and ensure that the objectives of the audits are met.

Recommendation

We recommend the following corrective action:

Modify TP 12.7 and 12.8 to require that the audit working papers be imaged, including the sample selected, the database associated with the sample, all sources used to test the sample and the errors found in the sample. (IOD-209)

5. Premium Policies and Procedures Need to be Developed and Enforced.

PBGC collects premiums from covered defined benefit pension plans to finance the operations. Premiums that are unpaid or underpaid are reflected as premiums receivable. In our FY 2001 audit work, we noted untimely premium refunds and inconsistent application of the premium receivable allowance methodology.

5.1 Premium refunds not authorized timely.

During FY 2001 testing of premium refunds, we noted 15 out of 48 refunds (31%) were authorized by PBGC ranging from four months to more than two years after the date of the refund request.

According to the 2000 PBGC Corporate Performance Measures reported in the 2000 Annual Report, management's goal is to "research and respond within 90 days to requests for premium refunds…." According to the 2001 PBGC Corporate Performance Measures reported in the 2001 Annual Report, this measure was refined to define the ninety-day period to be "…from receipt to completion of the request…."

PBGC has not made timely authorization and payment of refunds a priority. Although PBGC appears to be accounting for these refunds properly, untimely authorization of refunds delays the payments to the plans and results in poor customer service.

Recommendation

We recommend the following corrective action:

Strengthen compliance with premium refund timeliness goals. (FOD-289)

5.2 Premiums receivable allowance methodology not consistent.

During our FY 2001 testing of the premiums receivable allowance for doubtful accounts, we noted the method used to calculate the allowance has been changed through the years. PBGC calculates its allowance using billing and collection information from past and current years. The allowance calculation has been changed each year to include different amounts of historical information. For example, in FY 2001, the premium allowance estimate was calculated using data from FY 1994 – 2001, while in FY 2000, only five years of billing and collection data was used.

We also noted that the method of determining the cash receipts amount is ineffective for the purposes of the allowance calculation. PBGC calculates the cash receipts amount by identifying which payments were remitted along with returned Statements of Accounts (SOA). A SOA is mailed to a plan to alert the plan that it owes premiums, penalties and/or interest to PBGC. However, payments may be sent to PBGC in response to SOAs received, but are not identified as SOA-related cash receipts because SOAs do not accompany the payments. Therefore, PBGC cannot determine an accurate total for the cash receipts amount that is used in its calculation of the SOA allowance.

From our testing, it appears that PBGC does not consistently apply its allowance methodology. By changing the allowance calculation used each year, the allowance is not comparable from year to year. In addition, PBGC does not have the data to be able to calculate an accurate cash collections amount related to the SOA accounts receivable. If a plan does not mail its SOA in with its payment, PBGC is unable to determine if this amount relates to the SOA accounts receivable.

Recommendation

We recommend the following corrective action:

> *Adopt a methodology for the premiums receivable allowance calculation and apply it consistently each year. (FOD-290)*

6. Information Technology Security and Policies Need Strengthening.

The information security environment is dynamic. It requires constant attention and assessment to protect PBGC's information infrastructure and its business data. In our FY 2001 audit testing, we noted several periodic reviews that are not being performed, the information security function responsibilities appear to be fragmented, and change control standards are not consistently followed.

6.1 Periodic risk assessments not performed.

As a result of our FY 2001 audit work, we noted that PBGC does not conduct regular risk assessments of its environment and business processes. This increases the potential for threats and vulnerabilities affecting PBGC and its business applications. OMB Circular A-130, Appendix III, states:

> Security efforts are better served by generally assessing risks and taking actions to manage them, rather than continue to try to precisely measure risk. While formal risk analyses need not be performed, the need to determine adequate security will require that a risk-based approach be used. This risk assessment approach should include a consideration of the major factors in risk management: the value of the system or application, threats, vulnerabilities, and the effectiveness of current or proposed safeguards.

PBGC stated that they will begin to perform risk assessments on a regular basis from fiscal year 2002 onwards. These risk assessments will be performed in-house by PBGC staff.

In the absence of an up-to-date risk assessment, effective security controls may not be implemented to prevent or detect unauthorized or inappropriate access to PBGC systems and information. In addition, it would be difficult to determine the appropriate controls required to protect data sensitivity, integrity, and resources.

Recommendations

We recommend the following corrective actions:

> *Develop and document specific policies and procedures to perform risk assessments of business systems as required by OMB. (CTO-1)*
>
> *Implement the established policies and procedures for completing risk assessments to comply with OMB requirements. (CTO-2)*

6.2 Continued improvements needed in information security function.

In response to OIG audits of information security, PBGC has been implementing corrective actions to improve its information security program and practices. These included the appointment of an Information System Security Officer (ISSO). In our FY 2001 audit work, we noted that PBGC's organizational structure as it relates to information security roles appears to be fragmented.

The National Institute of Standards and Technology (NIST) Special Publication 800-14, *Generally Accepted Principles and Practices for Securing Information Technology Systems*, states in part:

> The people who run the system security program should understand the system, its mission, its technology, and its operating environment. Effective security management needs to be integrated into the management of the system. However, if a computer security program lacks appropriate independence, it may have minimal authority, receive little management attention, and have few resources.

Although a single individual, the ISSO, has been designated as responsible for information security, there exist a multitude of staffing and reporting lines for various security positions throughout PBGC that have no direct reporting relationship to the ISSO. This increases the risk that this role will become ineffective, as noted in NIST 800-14 above. At the present time, this position appears to be lacking the needed authority and accountability to promote an effective security program for PBGC.

Recommendation

We recommend the following corrective action:

> *Improve the information security structure to provide for enhanced responsibility and accountability. (IRMD-131)*

6.3 Periodic re-certification of PBGC systems' user accounts not performed.

System user accounts, commonly referred to as user IDs, determine the type and extent of access to business systems granted to an individual user. As a result of our FY 2001 audit testing, we noted that PBGC system user accounts are not periodically reviewed. PBGC has not established a formal policy or procedure to perform periodic reviews of user accounts, usually referred to as re-certifications.

NIST Special Publication 800-14, *Generally Accepted Principles and Practices for Securing Information Technology Systems*, states:

> It is necessary to periodically review user account management on a system. Reviews should examine the levels of access each individual has, conformity with the concept of least privilege, whether all accounts are still active, whether management authorizations are up-to-date, whether required training has been completed….

By not performing periodic re-certifications, the risk is increased that employees may retain access to systems they should not be authorized to use after they transfer positions or terminate employment with PBGC. This may diminish the integrity and reliability of data by increasing the risk of destruction or inappropriate disclosure of sensitive data.

Recommendations

We recommend the following corrective actions:

Develop and document policies and procedures for the performance of periodic re-certifications of PBGC systems' user accounts. (IRMD-132)

Implement periodic re-certifications of PBGC systems' user accounts. (IRMD-133)

6.4 Change control standards not consistently followed.

At PBGC, various groups develop applications software. We noted during our FY 2001 testing that the development groups do not consistently follow the change management standards. These standards require the PBGC Change Management Group to review the Peregrine (change management software package) records to see that access and change controls have been followed. This enables the Change Management Group to verify that changes have been appropriately approved. While reviewing change controls of the development groups for the Integrated Present Value of Future Benefits (IPVFB) and the Premium Accounting System (PAS), we noted that their changes are not entered into Peregrine at the beginning of the change cycle, as required.

Additionally, out of a sample of 17 changes tested, only one contained a documented Significant Occurrences Report (SOR), as required. These reports are used to document and inform individuals attending the weekly change management meetings of upcoming changes. Based on our testing, we noted that formal SORs are not always submitted.

Non-compliance or inconsistent adherence to existing policies, procedures, and standards increases the risk of unauthorized changes, errors or irregularities in the production environment.

Recommendation

We recommend the following corrective action:

> *Establish monitoring procedures to enforce compliance with existing change control policies, procedures, and standards. (IRMD-134)*

7. Multiemployer Non-recoverable Future Financial Assistance Lacks Procedures.

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 are issued in exchange for interest-bearing promissory notes and constitute an obligation of the plan. The present value of non-recoverable future financial assistance represents the estimated non-recoverable payments that PBGC will provide in the future to multiemployer plans that will not be able to meet their benefit obligations. In our FY 2001 audit work we noted several weaknesses in PBGC's implementation of the financial assistance program.

7.1 Actuarial data sources to calculate NRFFA liability not periodically evaluated.

During our FY 2001 testing of the present value of the Multiemployer Non-recoverable Future Financial Assistance (NRFFA) liability, we noted that a large number of the sample cases had old data sources, with source valuation dates as far back as 1985. For instance, one plan had a 16-year-old data source, while another had a 14-year-old data source.

Currently, PBGC does not have a procedure to re-evaluate data sources on a periodic basis to determine if updated data sources are available and should be used. The older the data source, the less credible the actuarial projections are. The impact could be either an overall increase or decrease to the present value of the NRFFA liability. New valuations should be obtained or completed for the cases for which PBGC determines an updated data source is necessary.

Recommendation

We recommend the following corrective action:

> *For cases with data sources more than five years old, implement a procedure to determine whether 1) an updated data source would provide a more accurate estimate of the NRFFA liability and 2) a valuation is available or can be completed without a significant burden on resources. (IOD-210)*

7.2 Promissory notes not safeguarded.

During our FY 2001 testing of the NRFFA liability, we noted that the January – September 2001 promissory notes and financial assistance disbursement documents were not filed in the General Accounting Branch (GAB) vault to safeguard these assets. In addition, two of 56 original promissory notes prepared for financial assistance payments were not found.

PBGC has written procedures pertaining to safekeeping official PBGC documents that require security and protection. However, these written procedures need to be strengthened to include timely storage. Promissory notes and other documents not properly stored may be lost.

Recommendation

We recommend the following corrective action:

> *Revise the Controller Division Consolidated Procedures Manual to require that the promissory notes and financial assistance disbursement documents are timely placed in the General Accounting Branch vault, and sign-out logs are periodically reviewed to ensure documents are returned timely. (FOD-291)*

8. Investment Management Policies and Procedures Are Needed.

PBGC manages trust fund assets, which are comprised of assets received from terminated pension plans that PBGC trustees. These trust fund assets are in several investment forms such as debt securities, equities, real estate, and commingled pooled funds. SSB is PBGC's custodian for commingled trust fund assets. PBGC contracts with various investment management firms to manage the assets, and oversees the investment managers to ensure the proper authorization of transactions and compliance with PBGC's investment policy. In our FY 2001 audit work, we noted that PBGC needs to strengthen its oversight of derivatives, and provide for regular Board of Director review of the investment policy.

8.1 Derivative instruments not reconciled and monitored periodically.

During FY 2001 testing of derivatives, we noted that a reconciliation of the custodian (SSB) and investment managers' (PIMCO and Wellington) derivative inventories had not been performed. Through our testing, we noted minor unexplained discrepancies between the investment managers' and SSB's valuations of options and currency forwards. We noted one of the currency forwards listed on the Wellington detail could not be found on the SSB detail. Finally, we noted unreconciled differences in the reporting of currency forwards.

In our testing of PBGC's accounting for derivatives, we noted that reverse repurchase collateral was erroneously classified as a "margin variation payable" by SSB. We noted the fair value of the currency forwards had been inappropriately accounted for in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*.

OMB Circular A-127, relating to financial management systems, states that "financial management systems must be in place to process and record financial events effectively and efficiently, and to provide complete, timely, reliable, and consistent information…."

Additionally, OMB Circular A-123 specifies that "management accountability is the expectation that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law."

The pricing of options is performed using pricing models; SSB independently prices investments and differences may arise as a result. Other differences are due to a different rounding off of exchange rates and gross versus net presentation of the inventories. In addition, PBGC and SSB have not been meeting periodically to discuss the changing reporting needs as new types of derivatives are purchased.

We noted that PBGC management relied heavily on the controls in place at SSB and the investment managers, PIMCO and Wellington, to properly account for its derivatives. PBGC reports its derivative activity in accordance with SSB's reports. This was due, in part, to PBGC personnel not having the necessary training to fully understand the accounting for derivatives. By relying on these outside parties without properly trained PBGC personnel monitoring and reviewing information provided, management increases the risk of inappropriately accounting for and reporting derivatives.

Recommendations

We recommend the following corrective actions:

> *Provide the appropriate training to PBGC management and employees to understand derivatives transactions, account for them properly, and disclose them properly in the financial statements (FOD-292)*
>
> *Actively monitor derivatives activity by monitoring SSB's accounting and reporting activities. (FOD-293)*
>
> *Reconcile SSB and the investment managers' derivative inventories and positions monthly. (FOD-294)*

8.2 Investment policy not periodically approved by the Board of Directors.

Based on our review, PBGC does not have a requirement for the Board to review and approve the investment policy on a periodic basis. PBGC's current investment policy was approved by the Board in 1994.

Since 1994, the Board has changed twice, and the new Board has not formally reaffirmed the existing investment policy. Furthermore, there have been changes in market conditions and the accounting for certain investments (including changes to the definition of derivative investments) since 1994 that may have warranted a revisit and assessment to the current investment policy.

Based on our review, PBGC's documented investment policy does not provide clear and complete provisions. For example, the investment policy states the following general guidelines:

> PBGC's environment is dynamic. The philosophy incorporated herein is to allow for sufficient flexibility in the management process to capture investment opportunities as they may occur, yet set forth reasonable parameters to ensure prudence and care in the execution of the investment program....Investment decisions will be geared primarily to maximizing investment return within acceptable levels of risk....prudent risk-taking is justifiable.

These statements alone do not provide clear guidance on the policy. The written policy is specific regarding some investment matters and general on other matters. For example, the specific guidelines within the investment policy state that "futures and options may be used for hedging purposes." However, the policy is unclear with respect to the use of derivatives for non-hedging purposes and the use of active versus passive investment strategies.

The equivocality of the policy does not easily allow anyone to determine if PBGC is, in fact, in compliance with its investment policy.

Recommendation

We recommend the following corrective action:

> *PBGC’s Board of Directors should review and approve PBGC’s investment policy once every two years. (FOD-295)*

TAB A

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

Office of the Executive Director

August 15, 2002

TO: Deborah Stover-Springer
Acting Inspector General

FROM: Steven A. Kandarian
Executive Director

Steven A. Kandarian

SUBJECT: FY 2001 Financial Statement Audit -
Draft Management Letter Report 2002-6/23157-5

We appreciate the opportunity to respond to the subject draft report. As you can see in the specific responses below, we agree with your recommendations and are actively pursuing corrective actions.

1. Classification of administrative expenses not properly supported.

Recommendation 1: Develop a system to specifically identify limitation administrative expenses and develop fiscal year budgets using the specific identification methods.

Response: Agree. We have been considering changes in our budget methodology, and we are currently vetting a draft of a new methodology among senior staff, DOL and OMB. The changes contemplate a system that would be more clearly aligned with our two major lines of business: pension insurance and termination of failed pension plans. The final structure of the new methodology is dependent upon that clearance process.

Recommendation 2: Provide documentation to support the accuracy of the allocation ratio and the propriety of designating administrative expenses as not being subject to limitation as defined in the appropriation law.

Response: Agree. As we have discussed with your office, we will address this recommendation by implementing a new system, subject to the clearance process noted above.

2.1 PRISM Trial Balance Reconciliation not properly maintained and reviewed.

Recommendation 3. Enforce PRISM Trial Balance Reconciliation review procedures in TP 11.1.

Response: Agree. We concur with the finding and have initiated corrective action to ensure that Trial Balance reconciliations are properly maintained and reviewed in a timely manner. We will look into the practicality of imaging the reconciliations. The technical procedure in the IOD Manual is currently being reviewed and an update is pending. This response also applies to Recommendations No. 4 and 5 below.

Recommendation 4. Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to establish a timetable to review variances in the PRISM Trial Balance Reconciliation.

Response: See comments under Recommendation No. 3 above.

Recommendation 5. Amend PRISM Trial Balance Reconciliation review procedures in TP 11.1 to require that the reconciliations be imaged in IPS after supervisory review.

Response: See comments under Recommendation No. 3 above.

2.2 Lack of management review procedures regarding Balancer Module Reconciliation.

Recommendation 6. Document a review procedure of PRISM Balancer Module reconciliations and unify the reconciliation documentation requirements by defining which print screens to keep as evidence of final resolution of the discrepancy, and what areas need to be completed in the summary sheets for management review.

Response: Agree. We concur with the finding and have initiated corrective action to include steps for documenting review procedures for Balancer reconciliations, and advising management on trends that may require additional monitoring. This response also applies to Recommendation No. 7 below.

Recommendation 7. Establish monitoring criteria for PRISM Balancer Reconciliations by defining the types of discrepancies that should be "flagged" by the staff and brought to management's attention for follow-up action.

Response: See comments under Recommendation No. 6 above.

2.3 Reconciliations of benefit payments to funding requests not performed timely or reviewed.

Recommendation 8. Amend TP 30.1 to include deadlines for completion of the monthly reconciliations and to require supervisory review and approval.

Response: Agree. We concur with the finding and have initiated corrective action to update the funding reconciliation procedures to establish a time frame for completing the reconciliation and management review.

3. Participants with incorrect pay status in PRISM.

Recommendation 9: Implement monthly procedures to submit a list of inactive participants to the PRISM team before the month-end cut-off to update the pay status to inactive and to verify that the submitted changes were made.

Response: Agree. We concur with the finding. An automated program currently exists to update records with lump sum pay-offs, and it is working as designed. We have generated a list of records meeting these criteria and have determined that a vast majority of the records were created prior to implementing the automated status change program. We expect to complete our review of the list in the near future, and will correct the status of these records in the upcoming months.

4. Participant data audits not properly supported and reviewed.

Recommendation 10: Modify TP 12.7 and 12.8 to require that the audit working papers be imaged, including the sample selected, the database associated with the sample, all sources used to test the sample and the errors found in the sample.

Response: Agree. We concur with the finding and have initiated process evaluation efforts that will result in modifying the existing Participant Data Audit procedures to require that the audit working papers be imaged, including the sample selected, the database associated with the sample, all sources used to test the sample and the errors found in the sample.

5.1 Premium refunds not authorized timely.

Recommendation 11: Strengthen compliance with premium refund timeliness goals.

Response: Agree. PBGC has taken steps in FY2002 to strengthen compliance with the Corporation's premium refund timeliness goal of achieving 75% within 90 days by fiscal year end. These actions have steadily improved the timeliness of refunds being issued within 90 days from 26% as reported in the 2001 annual report to 50% as of July 2002, fiscal year to date.

Recent improvements are demonstrated by the fact that during the 3rd quarter FY2002, approximately 79% of newly received refund requests were processed within 90 days.

5.2 Premiums receivable allowance methodology not consistent.

Recommendation 12: Adopt a methodology for the premiums receivable allowance calculation and apply it consistently each year.

Response: Agree. We agree it is important to utilize a consistent methodology for estimating the allowance for doubtful accounts. We have analyzed our premiums receivable allowance methodology and have determined that the historical information utilized in the analysis should be from the years premiums have been processed in PAS (FY1994) to the present year. This approach is consistent with the methodology used in FY 2001 and the methodology used in prior years except for FY 2000. We utilized a different methodology in FY 2000 (five year average), but we determined that the methodology used in FY2001 and in years prior to FY 2000 would be more appropriate.

Beyond FY 2002, the allowance methodology may be re-evaluated as we implement premium data quality improvements and system enhancements, which could provide a new basis for the underlying assumptions.

6.1 Periodic risk assessments not performed.

Recommendation 13: Develop and document specific policies and procedures to perform risk assessments of business systems as required by OMB.

Response: Agree. IRMD will revise PBGC's information security policy to require that risk assessments consistent with OMB Circular A-130 be performed as a part of updating system security plans, and will provide guidance in performing those risk assessments.

Recommendation 14: Implement the established policies and procedures for completing risk assessments to comply with OMB requirements.

Response: Agree. The Chief Technology Officer (CTO) will implement the updated policy and the guidance, and monitor compliance through the Information Systems Security Officer (ISSO).

6.2 Continued improvements needed in information security function.

Recommendation 15. Improve the information security structure to provide for enhanced responsibility and accountability.

Response: Agree. July 2002, PBGC hired an Assistant Executive Director and Chief Technology Officer (CTO). This position reports directly to PBGC's Executive Director. PBGC's IRMD Department now reports to the CTO. One of the CTO's responsibilities is overseeing the Information Security program. Starting the fourth quarter of FY 2002, the CTO plans to initiate the task of evaluating the roles and responsibilities of PBGC security staff and its management structure. This effort will include clarification for lines of reporting, accountability, and the effectiveness of the program.

6.3 Periodic re-certification of PBGC systems' user accounts not performed.

Recommendation 16: Develop and document polices and procedures for the performance of periodic re-certifications of PBGC systems' user accounts.

Response: Agree. PBGC expects to complete the implementation of a new process for managing system user accounts by July, 2003. The new process is based upon job profiling and a cross-platform security application that is centrally managed. The new process will include a re-certified baseline of user accounts.

Recommendation 17: Implement periodic re-certifications of PBGC systems' user accounts.

Response: Agree. IRMD will re-certify all user accounts, based upon job profile, once a year beginning in fiscal year 2004. The re-certification will be conducted in conjunction with the annual security assessment.

6.4 Change control standards not consistently followed.

Recommendation 18: Establish monitoring procedures to enforce compliance with existing change control policies, procedures, and standards.

Response: Agree. Since October 2001, a detailed compliance report has been generated and is reviewed monthly by the IRMD Technical Infrastructure Division (TID) manager. Starting October 2002, compliance reports by workgroups will be generated and distributed to IRMD Division Managers and contract program managers for review. Beginning in January 2003, the quarterly reports will begin reflecting Significant Occurrences Reporting (SOR) information.

7.1 Actuarial data sources to calculate NRFFA liability not periodically evaluated.

Recommendation 19. For cases with data sources more than five years old, implement a procedure to determine whether 1) an updated data source would provide a more accurate estimate of the NRFFA liability and 2) a valuation is available or can be completed without a significant burden on resources.

Response: Agree. IOD concurs with the finding and has initiated corrective action. A draft of the revised procedures is currently in distribution for review.

7.2 Promissory notes are not safeguarded.

Recommendation 20: Revise the Controller Division Consolidated Procedures Manual to require that the promissory notes and financial assistance disbursement documents are timely placed in the General Accounting Branch vault, and sign-out logs are periodically reviewed to ensure documents are returned timely.

Response: Agree. The original notes and financial assistance documents (security agreements) for the transactions in question were subsequently located. The procedure’s manual has been updated to reflect the current changes that require the staff to copy the note and file the original upon receipt. In addition, the accountant responsible for financial assistance will annotate on the schedule of payments maintained for each plan the date the note and other documents were filed. A log will be maintained for signing out and returning the documents to the vault.

8.1 Derivative instruments not reconciled and monitored periodically.

Recommendation 21: Provide the appropriate training to PBGC management and employees to understand derivatives transactions, account for them properly, and disclose them properly in the financial statements.

Response: Agree. On June 17, 2002, FOD provided a comprehensive all day derivatives training Course. Ira G. Kawaler, Ph.D. (Executive Enterprise Institute) conducted the training course on June 17, 2002. Dr. Kawaler is currently a member of the Financial Accounting Standards Board' s Derivative Implementation Group. Management and staff from the Controller Operations Division, Policy and Procedures Control Division, Treasury Division, Financial Operations Department and State Street Bank attended the training. The training provided: Derivative definition; Current market nomenclature and quoting conventions for derivative instruments; SFAS 133 accounting and derivative disclosure requirements; Speculation vs. hedging; Types of derivative instruments (e.g. futures contracts, forward contracts, options, swaps) and Types of hedges (e.g. fair value, cash flow); and, accounting requirements.

Recommendation 22: Actively monitor derivatives activity by monitoring SSB's accounting and reporting activities.

Response: Agree. In May 2002, the Controller Operations Division Investment Accounting Branch (IAB) implemented a review and reconciliation process that requires SSB and the investment manager to reconcile the derivative inventory and IAB to review the detail activity for the Commingled Fund and TWA each month. Any potential discrepancies and newly identified derivatives will be forwarded to the Financial Reporting and Account Analysis Group (monthly) and to the Controller (at minimum, quarterly) for review and concurrence. If a new type of derivative is identified in this review process it will be added to the derivative inventory and SSB and the investment manager will be notified. The procedures were updated and implemented during July, 2002.

Recommendation 23: Reconcile SSB and the investment managers' derivative inventories and positions monthly.

Response: Agree. FOD is currently reviewing the SSB and investment manager reconciliation of the derivative inventories. The reconciliation includes the derivative inventory, share position, notional value and margin variation. This reconciliation is being done on a monthly basis as part of the established monthly reconciliation procedures performed by SSB and the investment managers. This procedural change was developed in March 2002 and fully implemented in May 2002.

8.2 Investment policy not periodically approved by the Board of Directors.

Recommendation 24: PBGC's Board of Directors should review and approve PBGC's investment policy once every two years.

Response: Agree. During FY 2003, the PBGC Board of Directors will review and approve PBGC's investment policy, and every two years thereafter.