Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2005 and 2004 Financial Statements

Independent Auditor's Report

Independent Auditor's Report on Internal Control

Report of Independent Auditors on Compliance and Other Matters

Pension Benefit Guaranty Corporation's
Fiscal Year 2005 and 2004 Financial Statements
and Notes to the Financial Statements

November 15, 2005

2006-1/FA-0014-1

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

To the Board of Directors
Pension Benefit Guaranty Corporation

We contracted with Clifton Gunderson LLP, an independent certified public accounting firm, to audit the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of September 30, 2005. The audit was performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and the *GAO/PCIE Financial Audit Manual*.

Clifton Gunderson's financial statement audit of PBGC's Single-Employer and Multiemployer Program Funds found:

- The financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;

- PBGC's assertion about internal control over financial reporting and compliance with laws and regulations is fairly stated in all material respects;

- Four reportable conditions, including three repeated from Fiscal Year 2004: financial management systems integration, information security, and single-employer premiums; and a new reportable condition: preparedness for unanticipated incidences and disruptions;

- No instances of noncompliance with tested laws and regulations.

Clifton Gunderson is responsible for the accompanying auditor's report dated November 9, 2005, and the conclusions expressed in the report. We do not express opinions on PBGC's financial statements or internal control, nor do we draw conclusions on compliance with laws and regulations.

Clifton Gunderson's reports (2006-1/FA-0014-1) are available on our website at http://oig.pbgc.gov.

The financial statements of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2004 were audited by other auditors whose report dated November 12, 2004 expressed an unqualified opinion on those financial statements. Their reports (2005-2/23182-2) are also available on our website.

Sincerely,

Robert L Emmons

Robert L. Emmons
Inspector General

November 9, 2005

Audit of the Pension Benefit Guaranty Corporation's
Fiscal Year 2005 and 2004 Financial Statements
Audit Report 2006-1/FA-0014-1

Contents

Abbreviations

BAPD	Benefits Administration and Payment Department
BIA	Business impact analysis
COOP	Continuity of Operations Plan
CTO	Chief Technology Officer
FASD	Facilities and Services Department
FMFIA	Federal Managers' Financial Integrity Act of 1982
FOD	Financial Operations Department
FRS	Financial Reporting System
FY	Fiscal Year
GAO	Government Accountability Office
IPVFB	Integrated Present Value of Future Benefits
ISSO	Information Systems Security Officer
IT	Information Technology
LAN	Local Area Network
OIG	Office of Inspector General
OIT	Office of Information Technology
OMB	Office of Management and Budget
PA	Performance Accounting
PAS	Premium Accounting System
PBGC	Pension Benefit Guaranty Corporation
PCIE	President's Council on Integrity and Efficiency
PDFN	Past Due Filing Notices
PLUS	Pension and Lump Sum System
PRISM	Participant Records Information Systems Management
SLCM	System Life Cycle Methodology
SOA	Statements of Account
TAS	Trust Accounting System
U.S.C.	United States Code

Section I

Independent Auditor’s Report

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have audited the accompanying statements of financial condition of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of September 30, 2005, and the related statements of operations and changes in net position and cash flows for the year then ended. These financial statements are the responsibility of PBGC's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Single-Employer and Multiemployer Program Funds administered by the PBGC as of September 30, 2004 were audited by other auditors whose report dated November 12, 2004, expressed an unqualified opinion on those financial statements.

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

In our opinion, the fiscal year 2005 financial statements referred to above present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2005, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

By law, PBGC's Single-Employer and Multiemployer Program Funds must be self-sustaining. As of September 30, 2005, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of $22,776 million and $335 million, respectively. As discussed in Note 7 to the financial

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

statements, losses as of September 30, 2005 for the Single-Employer and Multiemployer Programs that are reasonably possible as a result of unfunded vested benefits are estimated to be $108,000 million and $418 million, respectively. In addition, as discussed in Note 15 to the financial statements, subsequent to September 30, 2005, business and financial conditions significantly deteriorated for a sponsor of two large single-employer plans that may terminate. Had these plan sponsor events occurred prior to September 30, 2005, PBGC's Single-Employer Program net deficit would have increased by $2,900 million. The PBGC's net deficit, and long-term viability, could be further impacted by losses from plans classified as reasonably possible (or from other plans not yet identified as potential losses) as a result of deteriorating economic conditions, the insolvency of a large plan sponsor or other factors. PBGC has been able to meet their short-term benefit obligations. However, as discussed in Note 1 to the financial statements, management believes that neither program at present has the resources to fully satisfy PBGC's long-term obligations to plan participants.

In accordance with *Government Auditing Standards,* we have also issued our reports dated November 9, 2005 on our consideration of PBGC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The financial statement highlights, management's discussion and analysis, actuarial valuation, annual performance report, and financial summary contain a wide range of data, some of which is not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with PBGC officials. Based on this limited work, we found no material inconsistencies with the financial statements.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2005

Section II

Independent Auditor's Report on Internal Control

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have examined management's assertion that Pension Benefit Guaranty Corporation (PBGC) maintained effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2005, based on the criteria contained in the Federal Managers' Financial Integrity Act of 1982 (FMFIA) (31 U.S.C. 3512). PBGC's management is responsible for maintaining effective internal control. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States, and, accordingly, included obtaining an understanding of the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in any internal control, misstatements due to error, fraud, losses, or noncompliance may occur and not be detected. Also, projections of any evaluation of the internal control to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that PBGC maintained effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2005 is fairly stated, in all material respects, based on criteria contained in FMFIA.

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

However, we noted certain matters involving the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations that, in our judgment, could adversely affect PBGC's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Reportable conditions we noted are as follows:

1. PBGC needs to integrate its financial management systems (Repeat Condition);
2. PBGC needs to complete its efforts to fully implement and enforce an effective information security program (Repeat Condition);
3. PBGC needs to improve controls related to single-employer premiums (Repeat Condition); and
4. PBGC needs to strengthen its preparedness for unanticipated incidences and disruptions.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that none of the reportable conditions described in this report are material weaknesses.

****

REPORTABLE CONDITIONS

1. PBGC Needs to Integrate Its Financial Management Systems (Repeat Condition)

A lack of integration of PBGC's financially significant systems was identified in prior year audits. These systems include: Financial Reporting System (FRS), Performance Accounting (PA) System, Trust Accounting System (TAS), Participant Records Information System Management (PRISM), Premium Accounting System (PAS), Integrated Present Value of Future Benefits (IPVFB), and Pension and Lump Sum System (PLUS).

Office of Management and Budget (OMB) Circular A-127 *Financial Management System* requires that financial management systems should be designed to provide for effective and efficient interrelationships between systems. This Circular states the following:

> The term "single, integrated financial management system" means a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls and data necessary to carry

> out financial management functions, manage financial operations of the agency and report on the agency's financial status to central agencies, Congress and the public. Unified means that the systems are planned for and managed together, operated in an integrated fashion, and linked together electronically in an efficient and effective manner to provide agency-wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs.

OMB’s Office of Federal Financial Management (OFFM – formerly the Joint Financial Management Improvement Program – JFMIP)’s “Core Financial System Requirements” document, lists the following integrated, financial management system attributes:

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

PBGC has effective controls to foster data integrity among its financially significant systems and is currently instituting methodologies that will promote further integration as systems are developed or changed, which was evidenced by the following:

- PBGC has contracted with a firm to implement an integrated solution for its financial management system;
- The system interface controls, used to reconcile data transmitted to and from the three general ledger applications, appear to be operating effectively;
- The manual interface controls, used to reconcile data between IPVFB and FRS, appear to be operating effectively; and
- Progress has been made on the development of a logical database model for Benefits Administration and Payment Department (BAPD) databases. Once database models are implemented for BAPD and Financial Operations Department (FOD), all new development will be required to conform to these models (physical re-design will be implemented as applications are developed or significantly enhanced).

Despite the above, we believe more needs to be done to integrate PBGC's existing financially significant systems. We identified the following factors relevant to the integration of systems:

<u>Lack of standard data classifications and common data elements</u>:

- The logical database models for BAPD and FOD were not yet implemented or available for our review during fiscal year (FY) 2005. Therefore, no centralized data catalog defining data elements or data access methods is available for current databases;

- The current decentralized database structure may lead to erroneous financial and participant data. For example, the same data elements are required to be reformatted or are used for different purposes across PBGC's various applications; and
- The current decentralized database structure may lead to untimely financial or participant data. Participant data must be reformatted and distributed to multiple PBGC systems; therefore, users may be relying on outdated information to make business decisions.

Duplication of transaction entry:

- PBGC uses three general ledger systems (TAS, PA, and FRS) to track trust, revolving and consolidated transactions rather than one system to track all three. Therefore, manual adjusting journal entries are required to synchronize the data between TAS, PA, and FRS;
- Probable and multiemployer plan data initially entered into IPVFB must be manually re-entered into a spreadsheet and then manually entered into FRS as adjusting journal entries;
- Plan data initially entered into the Case Administration System (CAS) application must be reentered into the TAS application's portfolio header;
- Plan contingency listings are determined using data extracted from PAS. However, plans with multiple filings must be manually aggregated before the plans can be classified; and
- Plan sponsor data initially entered into PAS to process receivables must also be entered into PA to process refunds.

Poor data integrity:

- The data in the PAS requires significant manual review and adjustment before it can be used for the purposes of reporting the premiums income and receivables in PBGC's financial statements.

Systems not planned or managed together:

- PBGC has not finalized the System Life Cycle Methodology (SLCM) that would foster integration for newly developed applications. Our testing identified the following issues:
  - The SLCM policy is still in the process of becoming a directive;
  - Several SLCM components are still in draft; and
  - The Enterprise Architecture component of the SLCM does not require compliance with the FOD and BAPD database models.

In the short term, PBGC’s ability to accurately and efficiently accumulate and summarize information required for internal and external financial reporting may be impacted. For this reason, this issue remains a reportable condition for FY 2005.

Recommendation:

We are encouraged by the improvement made and direction taken by PBGC in the areas noted above. However, we recommend that PBGC continue its efforts in this area by doing the following:

- Integrate its financial management systems, in accordance with OMB Circular A-127. **(OIG Control Number FOD-268)**

2. PBGC Needs to Complete its Efforts to Fully Implement and Enforce an Effective Information Security Program (Repeat Condition)

Improvement is needed to PBGC's enterprise-wide security management program as indicated in prior year audits. During our FY 2005 review of PBGC's existing security program, we noted that PBGC made the following progress:

- Office of Information Technology (OIT) has undertaken efforts to update the general security policies to reflect the current operating environment and complete the implementation of a fully functional and integrated enterprise-wide information security program;
- OIT is developing a high-level control framework of risk assessment/evaluation, establishing a risk mitigation plan and long term strategy encompassing control objectives, control techniques, monitoring and periodic re-evaluations;
- Effective with FY 2004, the Information System Security Officer (ISSO) now reports directly to the Chief Technology Officer (CTO). This reporting relationship provides the ISSO with improved visibility; and
- Background or suitability checks appear to be performed consistently for all federal employees and contractors across PBGC.

Our review of PBGC's existing security program revealed continuing weaknesses in controls that expose PBGC's financially significant systems and data to unauthorized access and/or modification. Weaknesses included the following:

- PBGC OIT security management, application owners, and application administrators have not completed effective security plans, risk assessments, certifications, and accreditations for PBGC's financially significant applications and general support systems. Furthermore, OIT has not developed or documented criteria and guidance to conduct risk assessments, certifications, and accreditations;
- PBGC has not consistently deployed security configurations across its financially significant applications and general support systems;
- PBGC has not formalized effective processes for granting, removing, and recertifying user access to financially significant applications and general support systems;

- Application owners or administrators do not perform periodic auditing and monitoring of user access and sensitive transactions for financially significant systems;
- OIT management's, application owners', and application administrators' duties are not clearly defined regarding user and security administration for financially significant systems;
- PBGC has granted developers inappropriate access to the production environment; and
- OIT has not developed a process that would allow the ISSO to manage and monitor the effectiveness of the entity-wide security program.

Until PBGC implements a complete enterprise-wide information security program, its ability to mitigate effectively the risk of unauthorized access to, and/or modification or disclosure of, sensitive PBGC financial information will be impaired.

We recommend that PBGC management perform the following:

- 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; and **(OIG Control Number CTO-5)**
- Develop enforcement mechanisms to ensure that all departments comply with the enterprise-wide information security program, as well as consistently enforce policies and procedures for logical access to information resources that are based on the concepts of "least possible privilege". **(OIG Control Number CTO-6)**

3. **PBGC Needs to Improve Controls Related to Single-Employer Premiums** (Repeat Condition)

Work performed during the 2003 financial statement audit and separately by PBGC's Inspector General, indicated several internal control weaknesses related to the single-employer premiums. Management has acknowledged the weaknesses associated with the single-employer premiums and has taken steps, including plans for a new premium accounting system, to improve the internal controls for premiums. However, we note continued internal control weaknesses in our 2005 audit.

The control weaknesses we identified relate to the following internal control objectives:

- Safeguarding of Assets - Ensuring PBGC collects all premiums due under statute. OMB Circular A- 123, *Management Accountability and Controls*, requires that: "Management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Management controls developed for agency programs should be logical, applicable, reasonably complete, and effective and efficient in accomplishing management objectives"; and

- Financial Reporting - Ensuring PBGC reports complete and reliable premium revenue and receivables in the financial statements. OMB Circular A-123 states that "transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports".

Data quality weaknesses:

During PAS conversion from the legacy Premium Processing System PBGC experienced difficulty in migrating data. This difficulty is the underlying cause of several of the control weaknesses noted during our testing. We noted the following weaknesses that PBGC is currently addressing:

- PBGC completed its draft Suspense Processing Manual on October 4, 2005, which defines monitoring controls to ensure that old items are cleared in a timely and correct manner. These controls have not been fully implemented; and
- PBGC indicated that the target for completing the development and implementation of its 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 is January 31, 2007.

PBGC does not have or maintain a complete list of plans that are required to file a Form 1 (premium filing form) with PBGC because it is a voluntary filing program. As such, PBGC's ability to effectively ensure that participating plans, particularly ones that are newly formed, have filed and paid premiums is limited. PBGC's ability to collect premiums owed is further limited because the Audit and Enforcement module within PAS to compare Form 1 filings to pension plan Form 5500 filings with the Department of Labor is not currently functional and will not be until the new premium system is implemented. Completing this analysis would enable PBGC to potentially identify plans which had not filed or paid their associated premiums. PBGC notes that resource constraints prevent them from developing and implementing software to reconcile the filings.

Impact of data quality weaknesses:

Because of the data quality issues noted, PBGC is unable to efficiently utilize two of its primary tools, Past Due Filing Notices (PDFN) and Statements of Account (SOA), to ensure the accuracy and completeness of premium data. The PDFN is a PAS-generated notice mailed to plans that have not submitted premiums. The SOA is also a PAS-generated notice used to ensure that underpaid or overpaid premiums from a plan sponsor are effectively rectified. We noted during the audit that PDFNs and SOAs are not mailed timely in accordance with PBGC policy because significant resources must be expended prior to mailing each notice to validate the information. Because these notices are not mailed in a timely manner, the potential exists that premiums will not be collected or that errors in amounts reflected in PAS will not be detected.

Other control matters:

Finally, we noted that all of the pertinent policies and procedures related to the premium accounting cycle have not been documented, communicated, or implemented throughout PBGC.

Recommendations:

While we acknowledge that PBGC is currently working toward the implementation of a new premium system with an implementation date currently scheduled for January 2007, we continue to recommend that PBGC:

- Develop and implement policies and procedures requiring all suspended transactions be researched and resolved in a timely manner and ensuring that adjustments are appropriately reviewed and approved; **(OIG Control Number FOD-333)**
- Implement controls to reconcile Form 1 information received by PBGC to Form 5500 information received by the Department of Labor as a means of identifying plans that have not filed or paid their associated premiums; and **(OIG Control Number FOD-334)**
- Compile a comprehensive polices and procedures manual for processing and accounting for premium revenue. **(OIG Control Number FOD-335)**

4. PBGC Needs to Strengthen Its Preparedness for Unanticipated Incidences and Disruptions

Although PBGC has developed significant elements of a Continuity of Operations Plan (COOP), service continuity control deficiencies impacted PBGC's ability to respond to a disruption in business operations. The purpose of service continuity controls is to ensure that when unexpected events occur, critical operations continue without interruption or are promptly resumed. Losing the capability to process and protect information maintained on PBGC's computer systems can significantly impact PBGC's ability to accomplish its mission, maintain productivity, and ensure financial integrity.

Strong service continuity controls would include adequate procedures to protect information resources and minimize the risk of unplanned interruptions and a plan to recover critical operations should interruptions occur. This plan should consider activities performed at PBGC's general support facilities (e.g. PBGC's LAN, wide area network, and telecommunications facilities), as well as the activities performed by users of specific applications. To determine whether these procedures will work as intended, PBGC should include them in their periodic testing in disaster simulation exercises.

Deficiencies in PBGC's COOP severely challenged its preparedness to continue its operations after unanticipated incidences and disruptions. As a result of these deficiencies, PBGC's recovery strategy failed after it experienced a significant hardware malfunction. This malfunction interrupted IT services needed to accomplish some critical PBGC functions at headquarters for nine (9) days.

We identified the following service continuity control deficiencies in PBGC's completion of key elements required in establishing a comprehensive COOP:

- PBGC'S business impact analysis (BIA), a key component in the contingency planning process, did not address contingencies relating to system outages and degradation issues at headquarters. The BIA's purpose is to correlate specific system components with the critical services that they provide, and based on that information, to characterize the consequences of a disruption to the system components. Results from the BIA should be appropriately incorporated into the analysis and strategy development efforts for PBGC's COOP;
- PBGC's COOP policy statement is too narrow. It only establishes one objective, (e.g. to continue to perform certain critical functions of PBGC in the event that an emergency renders or threatens to render the PBGC sites unusable). PBGC does not have a contingency planning policy statement that addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning of which COOP is one component; and
- PBGC's recovery strategies do not address disruption impacts and allowable outage times for the failure and/or degradation of critical system components at headquarters. The strategy does not include a combination of methods that complement one another to provide recovery capability over the full spectrum of incidents.

Recommendations:

- First, establish and implement a contingency planning policy statement that addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning; **(OIG Control Number FASD-130)**
- Second, conduct a BIA that addresses a full set of contingencies, including system outages and degradation issues at headquarters; and **(OIG Control Number FASD-131)**
- Finally, develop, document, implement, and test recovery strategies as part of PBGC's COOP to achieve the comprehensive set of objectives in PBGC's contingency planning policy statement and address the disruption impacts and allowable outage times identified in PBGC's comprehensive BIA. **(OIG Control Number FASD-132)**

****

In addition to the reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of PBGC in a separate letter dated November 9, 2005.

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

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2005

Section III

Independent Auditor's Report on Compliance and Other Matters

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance and Other Matters

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have audited the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the year ended September 30, 2005, and have issued our report thereon dated November 9, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The management of PBGC is responsible for complying with laws and regulations applicable to PBGC. As part of obtaining reasonable assurance about whether PBGC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to PBGC. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph or other matters that are required to be reported under *Government Auditing Standards*.

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

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2005

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

Section IV

Pension Benefit Guaranty Corporation's Fiscal Year 2005 and 2004 Financial Statements and Notes to the Financial Statements

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)	Single-Employer Program September 30, 2005	Single-Employer Program September 30, 2004	Multiemployer Program September 30, 2005	Multiemployer Program September 30, 2004	Memorandum Total September 30, 2005	Memorandum Total September 30, 2004
ASSETS						
Cash and cash equivalents	**$ 8,889**	$ 7,692	**$ 13**	$ 14	**$ 8,902**	$ 7,706
Investments, at market (Note 3):						
Fixed maturity securities	**33,160**	17,333	**1,134**	1,042	**34,294**	18,375
Equity securities	**12,284**	11,115	**0**	1	**12,284**	11,116
Real estate and real estate investment trusts	**29**	91	**0**	0	**29**	91
Other	**25**	23	**0**	0	**25**	23
Total investments	**45,498**	28,562	**1,134**	1,043	**46,632**	29,605
Receivables, net:						
Sponsors of terminated plans	**146**	129	**0**	0	**146**	129
Premiums (Note 9)	**425**	619	**0**	1	**425**	620
Sale of securities	**1,124**	1,756	**0**	0	**1,124**	1,756
Investment income	**359**	213	**13**	12	**372**	225
Other	**2**	2	**0**	0	**2**	2
Total receivables	**2,056**	2,719	**13**	13	**2,069**	2,732
Capitalized assets, net	**27**	20	**0**	0	**27**	20
Total assets	**$56,470**	$38,993	**$1,160**	$1,070	**$57,630**	$40,063

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

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF FINANCIAL CONDITION

(Dollars in millions)	Single-Employer Program September 30, 2005	2004	Multiemployer Program September 30, 2005	2004	Memorandum Total September 30, 2005	2004
LIABILITIES						
Present value of future benefits, net (Note 4):						
Trusteed plans	**$ 57,291**	$ 43,344	**$ 2**	$ 3	**$ 57,293**	$ 43,347
Plans pending termination and trusteeship	**1,918**	501	**0**	0	**1,918**	501
Settlements and judgments	**58**	65	**0**	0	**58**	65
Claims for probable terminations	**10,470**	16,926	**0**	0	**10,470**	16,926
Total present value of future benefits, net	**69,737**	60,836	**2**	3	**69,739**	60,839
Present value of nonrecoverable future financial assistance (Note 5)			**1,485**	1,295	**1,485**	1,295
Payable upon return of securities loaned	**6,939**	637	**0**	0	**6,939**	637
Unearned premiums	**210**	223	**8**	8	**218**	231
Due for purchases of securities	**2,290**	531	**0**	0	**2,290**	531
Accounts payable and accrued expenses (Note 6)	**70**	71	**0**	0	**70**	71
Total liabilities	**79,246**	62,298	**1,495**	1,306	**80,741**	63,604
Net position	**(22,776)**	(23,305)	**(335)**	(236)	**(23,111)**	(23,541)
Total liabilities and net position	**$ 56,470**	$ 38,993	**$1,160**	$1,070	**$ 57,630**	$ 40,063

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

Commitments and contingencies
(Notes 7, 8, 14 and 15)

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, 2005	2004	Multiemployer Program For the Years Ended September 30, 2005	2004	Memorandum Total For the Years Ended September 30, 2005	2004
UNDERWRITING						
Income:						
Premium (Note 9)	**$ 1,451**	$ 1,458	**$ 26**	$ 27	**$ 1,477**	$ 1,485
Other	**44**	24	**0**	0	**44**	24
Total	**1,495**	1,482	**26**	27	**1,521**	1,509
Expenses:						
Administrative	**311**	263	**0**	0	**311**	263
Other	**77**	(36)	**0**	0	**77**	(36)
Total	**388**	227	**0**	0	**388**	227
Other underwriting activity:						
Losses from completed and probable terminations (Note 10)	**3,954**	14,707	**0**	0	**3,954**	14,707
Losses from financial assistance (Note 5)			**204**	55	**204**	55
Actuarial adjustments (Note 4)	**220**	1,525	**0**	1	**220**	1,526
Total	**4,174**	16,232	**204**	56	**4,378**	16,288
Underwriting loss	**(3,067)**	(14,977)	**(178)**	(29)	**(3,245)**	(15,006)
FINANCIAL:						
Investment income (Note 11):						
Fixed	**1,755**	983	**79**	54	**1,834**	1,037
Equity	**2,114**	2,196	**0**	0	**2,114**	2,196
Other	**28**	18	**0**	0	**28**	18
Total	**3,897**	3,197	**79**	54	**3,976**	3,251
Expenses:						
Investment	**31**	25	**0**	0	**31**	25
Actuarial charges (Note 4):						
Due to passage of time	**2,618**	1,881	**0**	0	**2,618**	1,881
Due to change in interest rates	**(2,348)**	(1,619)	**0**	0	**(2,348)**	(1,619)
Total	**301**	287	**0**	0	**301**	287
Financial income	**3,596**	2,910	**79**	54	**3,675**	2,964
Net income (loss)	**529**	(12,067)	**(99)**	25	**430**	(12,042)
Net position, beginning of year	**(23,305)**	(11,238)	**(236)**	(261)	**(23,541)**	(11,499)
Net position, end of year	**$(22,776)**	$(23,305)	**$(335)**	$(236)	**$(23,111)**	$(23,541)

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

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, **2005**	2004	Multiemployer Program For the Years Ended September 30, **2005**	2004	Memorandum Total For the Years Ended September 30, **2005**	2004
OPERATING ACTIVITIES:						
Premium receipts	**$ 1,595**	$ 1,108	**$ 26**	$ 28	**$ 1,621**	$ 1,136
Interest and dividends received, net	**1,344**	1,155	**64**	64	**1,408**	1,219
Cash received from plans upon trusteeship	**218**	51	**0**	0	**218**	51
Receipts from sponsors/non-sponsors	**139**	120	**0**	0	**139**	120
Receipts from the missing participant program	**8**	3	**0**	0	**8**	3
Other receipts	**137**	4	**0**	0	**137**	4
Benefit payments - trusteed plans	**(3,301)**	(2,888)	**(1)**	(1)	**(3,302)**	(2,889)
Financial assistance payments			**(14)**	(10)	**(14)**	(10)
Settlements and judgments	**(5)**	(7)	**0**	0	**(5)**	(7)
Payments for administrative and other expenses	**(324)**	(278)	**0**	0	**(324)**	(278)
Net cash provided (used) by operating activities (Note 13)	**(189)**	(732)	**75**	81	**(114)**	(651)
INVESTING ACTIVITIES:						
Proceeds from sales of investments	**131,442**	44,332	**5,114**	1,267	**136,556**	45,599
Payments for purchases of investments	**(136,357)**	(39,497)	**(5,190)**	(1,342)	**(141,547)**	(40,839)
Change in security lending collateral	**6,301**	417	**0**	0	**6,301**	417
Net cash provided (used) by investing activities	**1,386**	5,252	**(76)**	(75)	**1,310**	5,177
Net increase (decrease) in cash and cash equivalents	**1,197**	4,520	**(1)**	6	**1,196**	4,526
Cash and cash equivalents, beginning of year	**7,692**	3,172	**14**	8	**7,706**	3,180
Cash and cash equivalents, end of year	**$ 8,889**	$ 7,692	**$ 13**	$ 14	**$ 8,902**	$ 7,706

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

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004

Note 1 -- Organization and Purpose

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and is subject to the provisions of the Government Corporation Control Act. Its activities are defined in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980, the Single-Employer Pension Plan Amendments Act of 1986, the Pension Protection Act of 1987, the Retirement Protection Act of 1994 and the Consolidated Appropriations Act, 2001. The Corporation insures the pension benefits, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans.

ERISA requires that PBGC programs be self-financing. The Corporation's principal operational resources are premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA, and investment income. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

As of September 30, 2005, the single-employer and multiemployer programs reported deficits of $22.776 billion and $335 million, respectively. The single-employer program had assets of nearly $56.5 billion which is offset by total liabilities of $79.2 billion, which includes a total present value of future benefits (PVFB) of approximately $69.7 billion. As of September 30, 2005, multiemployer program had assets of approximately $1.2 billion offset by approximately $1.5 billion in present value of nonrecoverable future financial assistance.

Notwithstanding these deficits, the Corporation has sufficient liquidity to meet its obligations for a number of years; however, neither program at present has the resources to fully satisfy PBGC's long-term obligations to plan participants.

Single-Employer and Multiemployer Program Exposure

Measures of risk in PBGC's insured base of plan sponsors suggest that the single-employer deficit may continue to worsen. PBGC's best estimate of the total underfunding in plans sponsored by companies with credit ratings below investment grade and classified by PBGC as reasonably possible of termination as of September 30, 2005, was $108 billion. The comparable estimates of reasonably possible exposure for 2004 and 2003 were $96 billion and $82 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 7). For 2005, this exposure is concentrated in the following sectors: manufacturing; transportation, communication and utilities; and services/other.

PBGC estimates that the total underfunding in single-employer plans exceeded $450 billion (unaudited), as of September 30, 2005, and as of September 30, 2004. PBGC's estimate of underfunding as of September 30, 2005, is largely (about 80%) based upon employers' reports to PBGC under section 4010 of ERISA of their December 31, 2004, market value of assets and termination liability. These values were then rolled forward to September 30, 2005, on a plan-by-plan basis using an average pension asset return from published reports, an average benefit accrual increment, and a liability adjustment factor to reflect the change in interest factors. The roll forward did not adjust for contributions, benefit payments, changes in liabilities due to the passage of time, or plan amendments since this information was not readily or reliably available. PBGC's exposure to loss is less than these amounts because of the statutory limits on insured pensions. For single-employer plans sponsored by employers that do not file with PBGC under section 4010 of ERISA, PBGC's estimates are based on data obtained from other filings and submissions with the government and from corporate annual reports for fiscal years ended in calendar 2004.

Total underfunding of multiemployer plans is estimated to exceed $200 billion (unaudited) at September 30, 2005. In 2004, PBGC estimated that multiemployer underfunding exceeded $150 billion (unaudited). Multiemployer plan data is much less current and complete than single-employer data--it is generally two years older and in some cases three years older than single-employer data and comes only from Form 5500 filings.

PBGC estimates that, as of September 30, 2005, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of $418 million. As of September 30, 2004 and 2003, these exposures were estimated at $108 million and $63 million, respectively.

There is significant volatility in plan underfunding and sponsor credit quality over time, which makes long-term estimates of PBGC's expected claims difficult. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized PBGC's experience to date and will likely continue. Among the factors that will influence PBGC's claims going forward are economic conditions affecting interest rates, financial markets, and the rate of business failures.

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

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from PBGC to allow the plan to continue to pay participants their guaranteed benefits. PBGC recognizes assistance as a loss to the extent that the plan is not expected to be able to repay these amounts from future plan contributions, employer withdrawal liability or investment earnings.

Note 2 -- Significant Accounting Policies

Basis of Presentation: The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from those estimates.

Valuation Method: A primary objective of PBGC's financial statements is to provide information that is useful in assessing PBGC's present and future ability to ensure that its plan beneficiaries receive benefits when due. Accordingly, PBGC values its financial assets at estimated fair value, consistent with the standards for pension plans contained in Statement of Financial Accounting Standards (FAS) No. 35 ("Accounting and Reporting by Defined Benefit Pension Plans"). PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from annuity prices from insurance companies, as described in the Statement of Actuarial Opinion. As described in Paragraph 21 of FAS No. 35, the assumptions are "those assumptions that are inherent in the estimated cost at the (valuation) date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." Also, in accordance with Paragraph 21 of FAS No. 35, PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.

Revolving and Trust Funds: PBGC accounts for its single-employer and multiemployer programs' revolving and trust funds on an accrual basis. Each fund is charged its portion of the benefits paid each year. PBGC has combined the revolving and trust funds for presentation purposes in the financial statements. The single-employer and multiemployer programs are separate programs by law and, therefore, PBGC reports them separately.

ERISA provides for the establishment of the revolving fund where premiums are collected and held. The assets in the revolving fund are used to cover deficits incurred by plans trusteed and provides funds for financial assistance. The Pension Protection Act of 1987 created a single-employer revolving (7th) fund that is credited with all premiums in excess of $8.50 per participant, including all penalties and interest charged on these amounts, and its share of earnings from investments. This fund may not be used to pay PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

The trust funds include assets PBGC acquires or expects to acquire with respect to terminated plans (e.g., investments) and investment income thereon. These assets generally are held by custodian banks. The trust funds support the operational functions of PBGC.

The trust funds reflect accounting activity associated with: (1) trusteed plans -- plans for which PBGC has legal responsibility–the assets and liabilities are reflected separately on PBGC's balance sheet, the income and expenses are included in the income statement and the cash flows from these plans are included in the cash flow statement, (2) plans pending termination and trusteeship -- plans for which PBGC has begun the process for termination and trusteeship by fiscal year-end - the assets and liabilities for these plans are reported as a net amount on the liability side of the balance sheet under Present value of future benefits, net. For these plans, the income and expenses are included in the income statement, but the cash flows are not included in the cash flow statement, and (3) probable terminations -- plans that PBGC determines are likely to terminate and be trusteed by PBGC–the assets and liabilities for these plans are reported as a net amount on the liability side of the balance sheet under Present value of future benefits, net. The accrued loss from these plans is included in the income statement as part of Losses from completed and probable terminations. The cash flows from these plans are not included in the cash flow statement. PBGC cannot exercise legal control over a plan's assets until it becomes trustee.

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

Cash and Cash Equivalents: Cash includes cash on hand and demand deposits as well as cash collateral retained as security for securities lent. Cash equivalents are securities with a maturity of one business day.

Investment Valuation and Income: PBGC bases market values on the last sale of a listed security, on the mean of the "bid-and-ask" for nonlisted securities or on a valuation model in the case of fixed-income securities that are not actively traded. These valuations are determined as of the end of each fiscal year. Purchases and sales of securities are recorded on the trade date. In addition, PBGC invests in and discloses its derivative investments in accordance with the guidance contained in FAS No. 133 ("Accounting for Derivative Instruments and Hedging Activities"), as amended. Investment income is accrued as earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are calculated using first-in, first-out for the revolving fund and average cost for the trust fund. PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC.

Sponsors of Terminated Plans, Receivables: The amounts due from sponsors of terminated plans or members of their controlled group represent the settled, but uncollected, claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for estimated uncollectible amounts. PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. The Corporation will report any such future amounts in the period they are realizable. Income and expenses related to amounts due from sponsors are reported in the underwriting section of the Statements of Operations and Changes in Net Position. Interest earned on settled claims for employer liability and due and unpaid employer contributions (DUEC) is reported as "Income: Other." The change in the allowances for uncollectible employer liability and DUEC is reported as "Expenses: Other."

Premiums: Premiums receivable represent the estimated earned but unpaid portion of the premiums for plans that have a plan year commencing before the end of PBGC's fiscal year and past due premiums deemed collectible, including penalties and interest. The liability for unearned premiums represents an estimate of payments received during the fiscal year that cover the portion of a plan's year after PBGC's fiscal year-end. Premium income represents actual and estimated revenue generated from self-assessments from defined benefit pension plans as required by Title IV of ERISA (see Note 9).

Capitalized Assets: Capitalized assets include furniture and fixtures, EDP equipment and internal-use software. Beginning in fiscal year 2004, PBGC, in compliance with AICPA Statement Of Position 98-1 and FASB EITF 97-13 began to account for the cost of computer software developed for internal use. This includes costs for internally developed software incurred during the application development stage (system design including software configuration and software interface, coding, testing including parallel processing phase). These costs are shown net of depreciation and amortization.

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

The values of the PVFB are particularly sensitive to changes in underlying estimates and assumptions. These estimates and assumptions could change and the impact of these changes may be material to PBGC's financial statements (see Note 4).

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

(2) Pending Termination and Trusteeship--represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans for which termination action has been initiated and/or completed prior to fiscal year-end. Unlike trusteed plans, the liability for plans pending termination and trusteeship is shown net of plan assets.

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

(4) Net Claims for Probable Terminations-- In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies) PBGC recognizes net claims for probable terminations which represent PBGC's best estimate of the losses, net of plan assets and the present value of expected recoveries (from sponsors and member controlled group) for plans that are likely to terminate within twelve months of the financial statement issuance date. These estimated losses are based on conditions that existed as of PBGC's fiscal year-end. Management believes it is likely that one or more events subsequent to PBGC's fiscal year-end will occur, confirming the loss. Criteria used for classifying a specific plan as a probable termination include, but are not limited to, one or more of the following conditions: the plan sponsor is in liquidation or comparable state insolvency proceeding with no known solvent controlled group member; sponsor has filed or intends to file for distress plan termination; or PBGC seeks involuntary plan termination. In addition, management takes into account other economic events and factors in making judgments regarding the classification of a plan as a probable termination. These events and factors may include, but are not limited to: the plan

sponsor is in bankruptcy or has indicated that a bankruptcy filing is imminent; the plan sponsor has stated that plan termination is likely; the plan sponsor has received a going concern opinion from its independent auditors; or the plan sponsor is in default under existing credit agreement(s).

In addition, a reserve for large unidentified probable losses is recorded based on actual PBGC experience, as well as the historical industry bond default rates. This reserve has been developed by segregating plan sponsors listed on the contingency list, with plan funding ratios less than or equal to 80%, with aggregate underfunding equal to or greater than $50 million into risk bands which reflect their level of credit risk. A reserve for small unidentified probable losses and incurred but not reported (IBNR) claims is also recorded based on an actuarial loss development methodology (triangulation method) (see Note 4).

(5) PBGC identifies certain plans as high risk if the plan sponsor meets one or more criteria that include, but are not limited to, the following conditions: sponsor is in Chapter 11 proceedings; sponsor received a minimum funding waiver within the past five years; sponsor granted security to an unsecured creditor as part of a renegotiation of debt within the past two years; sponsor is known to have been in default on existing debt within the past two years (regardless of whether it received a waiver of default); or sponsor's unsecured debt is rated CCC+/Caa1 or lower by S&P or Moody's respectively. PBGC specifically reviews each plan identified as high risk and classifies those plans as probable if, based on available evidence, PBGC concludes that plan termination is likely. Otherwise, high risk plans are classified as reasonably possible.

(6) In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies), PBGC's exposure to losses from plans of companies that are classified as reasonably possible is disclosed in footnotes. In order for a plan sponsor to be specifically classified as reasonably possible, it must first have $5 million or more of underfunding, as well as meet additional criteria. Criteria used for classifying a company as reasonably possible include, but are not limited to, one or more of the following conditions: the plan sponsor is in Chapter 11 reorganization; funding waiver pending or outstanding with the Internal Revenue Service (IRS); sponsor missed minimum funding contribution; sponsor's bond rating is below-investment-grade for Standard & Poor's

(BB+) or Moody's (Ba1); sponsor has no bond rating but unsecured debt is below investment grade; or sponsor has no bond rating but the ratio of long-term debt plus unfunded benefit liability to market value of shares is 1.5 or greater (see Note 7).

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

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by PBGC in the future to multiemployer plans that will not be able to meet their benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future guaranteed benefits and expenses and the market value of plan assets, including the present value of future amounts expected to be paid by employers, for those plans that are expected to require future assistance. The amount reflects the rates at which, in the opinion of management, these liabilities (net of expenses) could be settled in the market for single-premium nonparticipating group annuities issued by private insurers (see Note 5).

A liability for a particular plan is included in the Present Value of Nonrecoverable Future Financial Assistance when it is determined that the plan is currently, or will likely become in the future, insolvent and will require assistance to pay the participants their guaranteed benefit. Determining insolvency requires considering several complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status.

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

Losses from Completed and Probable Terminations: Amounts reported as losses from completed and probable terminations represent the difference as of the actual or expected date of plan termination (DOPT) between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see

Note 10). When a plan terminates, the previously recorded probable Net claim is reversed and newly estimated DOPT plan assets, recoveries and PVFB are netted and reported on the line PVFB - Plans pending termination and trusteeship (this value is usually different than the amount previously reported), with any change in the estimate being recorded in the Statements of Operations and Changes in Position. In addition, the plan's net income from date of plan termination to the beginning of PBGC's fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to PBGC's inventory of terminated plans.

Actuarial Adjustments and Charges (Credits): PBGC classifies actuarial adjustments related to changes in method and the effect of experience as underwriting activity; actuarial adjustments are the result of the movement of plans from one valuation methodology to another (e.g., nonseriatim to seriatim) and of new data (e.g., deaths, revised participant data). Actuarial charges (credits) related to changes in interest rates and passage of time are classified as financial activity. These adjustments and charges (credits) represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 4).

Depreciation and Amortization: PBGC calculates depreciation on the straight-line basis over estimated useful lives of 5 years for equipment and 10 years for furniture and fixtures. PBGC calculates amortization for capitalized software, which includes certain costs incurred for purchasing and developing software for internal use, on the straight-line basis over estimated useful lives not to exceed 5 years, commencing on the date that the Corporation determines that the internal-use software is implemented. Routine maintenance and leasehold improvements (the amounts of which are not material) are charged to operations as incurred.

Reclassification: Certain amounts in the 2004 financial statements have been reclassified to be consistent with the 2005 presentation.

Note 3 -- Investments

Premium receipts are invested in U.S. Treasury securities.

The trust funds include assets PBGC acquires or expects to acquire with respect to terminated plans (e.g., recoveries from sponsors) and investment income thereon. These assets generally are held by custodian banks. The basis and market value of the investments by type are detailed below as well as related investment profile data. The basis indicated is cost of the asset if acquired after the date of plan termination or the market value at date of plan termination if the asset was acquired as a result of a plan's termination. PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC. As the table below illustrates, the market value of investments of the single-employer program increased significantly from September 30, 2004, to September 30, 2005. This was primarily due to (1) a large amount of cash available at September 30, 2004, which was deployed to the new fixed income managers early in FY 2005 and (2) significant inflow of assets from trusteed plans in 2005. This resulted in a significant increase in income from fixed income securities. Note 11 provides the components of investment income.

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

	September 30, 2005		September 30, 2004	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$21,562**	**$21,417**	$15,095	$15,667
Commercial paper	**336**	**336**	188	188
Asset backed securities	**3,286**	**3,265**	399	396
Corporate and other bonds	**8,194**	**8,142**	1,050	1,082
Subtotal	**33,378**	**33,160**	16,732	17,333
Equity securities	**8,565**	**12,284**	7,536	11,115
Real estate and real estate investment trusts	**33**	**29**	83	91
Insurance contracts and other investments	**32**	**25**	38	23
Total *	**$42,008**	**$45,498**	$24,389	$28,562

* This includes securities on loan at September 30, 2005, and September 30, 2004, with a market value of $6.769 billion and $622 million, respectively.

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

	September 30, 2005		September 30, 2004	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$1,151**	**$1,134**	$1,006	$1,042
Equity securities	**0**	**0**	0	1
Total	**$1,151**	**$1,134**	$1,006	$1,043

INVESTMENT PROFILE

	September 30, 2005	2004
Fixed-Income Assets		
Average Quality	**AAA**	AAA
Average Maturity (years)	**16.6**	15.2
Duration (years)	**10.4**	9.1
Yield to Maturity (%)	**4.8**	4.4
Equity Assets		
Average Price/Earnings Ratio	**20.2**	20.4
Dividend Yield (%)	**1.6**	1.7
Beta	**1.03**	0.98

In addition, PBGC's trusteed liability return was 2.6% and the duration (years) of these liabilities was 9.93 in 2005.

Derivative Instruments: Derivatives are accounted for at market value in accordance with Statement of Financial Accounting Standards No. 133, as amended. Derivatives are marked to market with changes in value reported within financial income. These instruments are used to mitigate risk and/or enhance PBGC's investment returns. The standard requires disclosure of fair value of these instruments. During fiscal years 2004 and 2005, PBGC invested in investment products, which used various U.S. and non-U.S. derivative instruments including but not limited to: equity index futures contracts, money market and government bond futures contracts, swap contracts, swaption contracts, stock warrants and rights, debt option contracts and foreign currency forward and option contracts. Some of these derivatives are traded on organized exchanges and thus bear minimal credit risk. The counterparties to PBGC's non-exchange-traded derivative contracts are major financial institutions. PBGC has never experienced non-performance by any of its counterparties.

Futures are exchange-traded contracts specifying a future date of delivery or receipt of a certain amount of a specific tangible or intangible product. The futures exchange's clearinghouses clear, settle, and guarantee transactions occurring through its facilities. Institutional investors hold these future contracts on behalf of PBGC as efficient and liquid substitutes for purchases and sales of financial market indices and securities. Open futures positions are marked to market daily. An initial margin of generally 1 to 6 percent is maintained with the broker in Treasury bills or similar instruments. In addition, futures contracts require daily settlement of variation margin resulting from the marks to market. In periods of extreme volatility, margin calls may create a high liquidity demand on the underlying portfolio. To mitigate this, PBGC maintains adequate liquidity in its portfolio to meet these margin calls.

A swap is an agreement between two parties to exchange different financial returns on a notional investment amount. For example, an interest rate swap involves exchanges of fixed rate and floating rate interest. There is no exchange of the underlying principal. During fiscal years 2004 and 2005, gains and losses from settled margin calls (e.g., from futures, swaps, and options) are reported in Investment income on the Statement of Operations and Changes in Net Position.

PBGC's investment managers employ a variety of derivative investment strategies including: investment of foreign currency forward and option contracts used to adjust overall currency exposure to reflect the investment views of the portfolio managers regarding relationships between currencies; investment in swap and swaption contracts to adjust exposure to interest rates, fixed income securities exposure, and to generate income based on the investment views of the portfolio managers regarding interest rates, indices and debt issues; and investment in stock warrants and rights that allow the purchase of securities at a stipulated price within a specified time limit. Derivative instruments are not used to create leverage in PBGC's investment portfolio.

The following table summarizes the notional amounts and fair market values of derivative financial instruments held or issued for trading as of September 30, 2005, and September 30, 2004.

INTEREST RATE CONTRACTS (IRC)	9/30/05 Notional	9/30/05 FMV	9/30/04 Notional	9/30/04 FMV
(Dollars in millions)				
Forwards	$ 149	$ 0	$ 20	$ 0
Futures	5,098	6	2,254	15
Contracts in a receivable position	1,645	15	1,807	16
Contracts in a payable position	3,453	(9)	447	(1)
Swap Agreements	4,385	38	223	5
Options purchased (long)	2	0	0	0
Options written (sold short)	80	0	135	(1)

FOREIGN EXCHANGE CONTRACTS (FEC)	9/30/05 Notional	9/30/05 FMV	9/30/04 Notional	9/30/04 FMV
Forwards	$1,129	$ (3)	$ 322	$ 2
Options purchased (long)	0	0	1	0

Security Lending: PBGC participates in a security lending program administered by its custodian bank. The custodian bank requires collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank. In addition to the lending program managed by the custodian bank, some of PBGC's investment managers are authorized to invest in repurchase agreements and reverse repurchase agreements. The manager either receives cash as collateral or pays cash out to be used as collateral. Any cash collateral received is invested. The total value of securities on loan at September 30, 2005, and September 30, 2004, was $6.769 billion and $622 million, respectively. Securities on loan have increased significantly since September 30, 2004, due to an ongoing demand for fixed-income securities to lend and the new capacity to lend such securities provided by approximately $12.833 billion of new fixed-income securities as of September 30, 2005.

The amount of cash collateral received for these loaned securities was $6.939 billion at September 30, 2005, and $637 million at September 30, 2004. These amounts are recorded in cash and are offset with a corresponding liability. PBGC had earned income from securities lending of $4.0 million as of September 30, 2005 and $1.1 million as of September 30, 2004.

Of the $6.769 billion market value of securities on loan at September 30, 2005, approximately 92% are invested in U.S. government securities and 8% in U.S. corporate securities. PBGC had available approximately $15.960 billion of securities available for securities lending at September 30, 2005.

Note 4 -- Present Value of Future Benefits

The following table summarizes the actuarial adjustments, charges and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 2005 and 2004.

For FY 2005, PBGC used a 25-year select interest factor of 5.2% followed by an ultimate factor of 4.5% for the remaining years. In FY 2004, PBGC used a 25-year select interest factor of 4.8% followed by an ultimate factor of 5.0% for the remaining years. These factors were determined to be those needed, given the mortality assumptions, to continue to match the survey of annuity prices provided by the American Council of Life Insurers (ACLI). Both the interest factor and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in the opinion of management, the liabilities (net of administrative expenses) could be settled in the market at September 30, for the respective year, for single-premium nonparticipating group annuities issued by private insurers. Many factors, including Federal Reserve policy, may impact these rates.

For September 30, 2005, PBGC used the 1994 Group Annuity Mortality (GAM) 94 Static Table (with margins), set forward one year and projected 22 years to 2016 using Scale AA. For September 30, 2004, PBGC used the same table, set forward one year, projected 20 years to 2014 using Scale AA. The number of years that PBGC projects the mortality table reflects the number of years from the 1994 base year of the table to the end of the fiscal year (11 years in 2005 versus 10 years in 2004) plus PBGC's calculated duration of its liabilities (11 years in 2005 versus 10 years in 2004). PBGC's procedure is based on the procedures recommended by the Society of Actuaries UP-94 Task Force (which developed the GAM94 table) for taking into account future mortality improvements.

PBGC continues to utilize the results of its 2004 mortality study. The study showed that the mortality assumptions used in FY 2003 reflected higher mortality than was realized in PBGC's seriatim population. Therefore, PBGC adopted a base mortality table (i.e., GAM94 set forward one year instead of GAM94 set forward two years) that better reflects past mortality experience. The ACLI survey of annuity prices, when combined with the mortality table, provides the basis for determining the interest factors used in calculating the PVFB. The insurance annuity prices, when combined with the stronger mortality table, result in a higher interest factor. The 2004 increase in the liability due to the change in the mortality table is included in the actuarial adjustments. There was a compensating decrease in the actuarial charge due to the change in interest rates.

The reserve for administrative expenses in the 2005 and 2004 valuations were assumed to be 1.18 percent of benefit liabilities plus additional reserves for cases whose plan asset determinations, participant database audits and actuarial valuations were not yet complete. The expense assumption was based on a study performed for PBGC in 2000 by a major accounting firm. The factors to determine the additional reserves were based on case size, number of participants and time since trusteeship.

The present values of future benefits for trusteed multiemployer plans for 2005 and 2004 reflect the payment of assistance and the changes in interest and mortality assumptions, passage of time and the effect of experience.

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

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

(Dollars in millions)	September 30, 2005		2004	
Present value of future benefits, at beginning of year -- Single-Employer, net		**$ 60,836**		$44,641
Estimated recoveries, prior year		**364**		68
Assets of terminated plans pending trusteeship, net, prior year		**678**		172
Present value of future benefits at beginning of year, gross		**61,878**		44,881
Settlements and judgments, prior year		**(65)**		(67)
Net claims for probable terminations, prior year		**(16,926)**		(5,207)
Actuarial adjustments -- underwriting:				
Changes in method and assumptions	**$ 17**		$ 1,340	
Effect of experience	**203**		185	
Total actuarial adjustments -- underwriting	**220**		1,525	
Actuarial charges -- financial:				
Passage of time	**2,618**		1,881	
Change in interest rates	**(2,348)**		(1,619)	
Total actuarial charges -- financial	**270**		262	
Total actuarial charges, current year		**490**		1,787
Terminations:				
Current year	**21,191**		6,926	
Changes in prior year	**(292)**		(427)	
Total terminations		**20,899**		6,499
Benefit payments, current year*		**(3,685)**		(3,006)
Estimated recoveries, current year		**(343)**		(364)
Assets of terminated plans pending trusteeship, net, current year		**(3,039)**		(678)
Settlements and judgments, current year		**58**		65
Net claims for probable terminations:				
Future benefits**	**23,918**		30,953	
Estimated plan assets and recoveries from sponsors	**(13,448)**		(14,027)	
Total net claims, current year		**10,470**		16,926
Present value of future benefits, at end of year -- Single-Employer, net		**69,737**		60,836
Present value of future benefits, at end of year -- Multiemployer		**2**		3
Total present value of future benefits, at end of year, net		**$ 69,739**		$60,839

* The benefit payments of $3,685 million and $3,006 million include $384 million in 2005 and $119 million in 2004 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $23,918 million and $30,953 million for fiscal years 2005 and 2004, respectively, include $137 million and $431 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $23,781 million and $30,522 million, respectively, in net claims for specifically identified probables.

The following table details the assets that make up single-employer terminated plans pending termination and trusteeship:

ASSETS OF SINGLE-EMPLOYER PLANS PENDING TERMINATION AND TRUSTEESHIP, NET

	September 30, 2005		September 30, 2004	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
U.S. Government securities	**$ 0**	**$ 0**	$ 3	$ 3
Corporate and other bonds	**1,043**	**1,053**	265	281
Equity securities	**1,968**	**1,992**	364	382
Insurance contracts	**2**	**2**	2	2
Other	**(7)**	**(8)**	10	10
Total	**$3,006**	**$3,039**	$644	$678

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

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

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS

(Dollars in millions)	September 30, 2005		2004	
Net claims for probable terminations, at beginning of year		**$16,926**		$ 5,207
Change in IBNR				(41)
New claims	**$ 4,738**		$14,407	
Actual terminations	**(10,637)**		(3,258)	
Deleted probables	**(83)**		(243)	
Change in benefit liabilities	**(205)**		929	
Change in plan assets	**(269)**		(75)	
Loss (credit) on probables		**(6,456)**		11,760
Net claims for probable terminations, at end of year		**$10,470**		$16,926

The following table itemizes the probable exposure by industry:

PROBABLES EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2005**	FY 2004
Transportation, Communication and Utilities	**$ 9,570**	$15,057
Manufacturing	**612**	630
Agriculture, Mining, and Construction	**37**	-
Wholesale and Retail Trade	**18**	219
Finance, Insurance, and Real Estate	**-**	569
Services/Other	**233**	451
Total	**$10,470**	$16,926

For further detail, see Note 2 subpoint (4)

The following table shows what has happened to plans classified as probables. This table does not capture or include those plans that were not previously classified as probable before they terminated.

PROBABLES EXPERIENCE
As Initially Recorded Beginning in 1987

(Dollars in millions)	Status of Probables from 1987-2004 at September 30, 2005			
Beginning in 1987, number of plans reported as Probable:	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Probables terminated	271	79%	$21,788	76%
Probables not yet terminated or deleted	6	2	5,774	20
Probables deleted	67	19	1,105	4
Total	344	100%	$28,667	100%

Note 5 -- Multiemployer Financial Assistance

PBGC provides financial assistance to multiemployer defined benefit pension plans in the form of loans. An allowance is set up to the extent that repayment of these loans is not expected.

NOTES RECEIVABLE
MULTIEMPLOYER FINANCIAL ASSISTANCE

	September 30,	
(Dollars in millions)	**2005**	2004
Gross balance at beginning of year	**$ 71**	$ 61
Financial assistance payments-current year	**14**	10
Subtotal	**85**	71
Allowance for uncollectible amounts	**(85)**	(71)
Net balance at end of year	**$ 0**	$ 0

The losses from financial assistance reflected in the Statements of Operations and Changes in Net Position include period changes in the estimated present value of nonrecoverable future financial assistance.

PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE

	September 30,	
(Dollars in millions)	**2005**	2004
Balance at beginning of year	**$1,295**	$1,250
Changes in allowance:		
Losses from financial assistance	**204**	55
Financial assistance granted (previously accrued)	**(14)**	(10)
Balance at end of year	**$1,485**	$1,295

Note 6 -- Accounts Payable and Accrued Expenses

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

ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	September 30,	
(Dollars in millions)	**2005**	2004
Annual leave	**$ 5**	$ 5
Other payables and accrued expenses	**65**	66
Accounts payable and accrued expenses	**$70**	$71

Note 7 -- Contingencies

Single-employer plans sponsored by companies whose credit quality is below investment grade pose a greater risk of being terminated. In addition, there are some multiemployer plans that may require future financial assistance. The amounts disclosed below represent the Corporation's best estimates of the possible losses in these plans given the inherent uncertainties about these plans.

In accordance with Statement of Financial Accounting Standards No. 5, PBGC classified a number of these companies as reasonably possible terminations as the sponsors' financial condition and other factors did not indicate that termination of their plans was likely as of year-end. The best estimate of aggregate unfunded vested benefits exposure to PBGC for the companies' single-employer plans classified as reasonably possible as of September 30, 2005, was $108 billion.

The estimated unfunded vested benefits exposure has been calculated as of December 31, 2004. PBGC calculated this estimate as in previous years by using data obtained from filings and submissions with the government and from corporate annual reports for fiscal years ending in calendar 2004. The Corporation adjusted the value reported for liabilities to the December 31, 2004, PBGC select interest rate of 3.9%. When available, data were adjusted to a consistent set of mortality assumptions. The underfunding associated with these sponsors' plans would generally tend to be greater at September 30, 2005, because of the economic conditions that existed between December 31, 2004, and September 30, 2005. The Corporation did not adjust the estimate for events that occurred between December 31, 2004, and September 30, 2005.

The following table itemizes the reasonably possible exposure by industry:

REASONABLY POSSIBLE EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2005**	FY 2004
Manufacturing	**$ 71,332**	$51,325
Transportation, Communication and Utilities	**17,567**	26,985
Services/Other	**8,623**	8,725
Wholesale and Retail Trade	**7,296**	5,674
Agriculture, Mining and Construction	**1,731**	1,866
Finance, Insurance, and Real Estate	**1,490**	1,098
Total	**$108,039**	$95,673

FY 2004 amounts were reclassified to conform to the NAIC classification codes

PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 5) for multiemployer plans that PBGC estimated may require future financial assistance. In addition, PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of $418 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 5), or reasonably possible as the present value of guaranteed future benefit and expense payments net of any future contributions or withdrawal liability payments as of the later of September 30, 2005, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2005. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts required consideration of many complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

PBGC used select and ultimate interest rate assumptions of 5.2% for the first 25 years after the valuation date and 4.5% thereafter. The Corporation also used the 1994 Group Annuity Mortality Static Table (with margins), set forward one year, projected 22 years to 2016 using Scale AA.

Note 8 -- Commitments

PBGC leases its office facility under a new commitment that began on January 1, 2005, and expires December 10, 2018. The new lease agreement was entered into because of the need for additional office space. This lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, PBGC is leasing space for field benefit administrators. These leases began in 1996 and expire in 2013. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2005, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS
(Dollars in millions)

Years Ending September 30,	Operating Leases
2006	$ 18.7
2007	18.7
2008	18.0
2009	17.5
2010	17.3
Thereafter	118.6
Minimum lease payments	$208.8

Lease expenses were $18.0 million in 2005 and $15.6 million in 2004.

Note 9 -- Premiums

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and penalties on the unpaid portion of or underpayment of premiums. Interest continues to accrue until the premium and the interest due are paid. The amount of penalty that can be levied is capped at 100 percent of the premium late payment or underpayment. Annual flat-rate premiums for the single-employer program are $19 per participant. Underfunded single-employer plans also pay variable-rate premiums of $9 per $1,000 of underfunding if not exempt from the variable-rate premiums. Annual flat-rate premiums for the multiemployer program are $2.60 per participant and there are no variable-rate premiums. PBGC recorded premium income, excluding interest and penalty, of approximately $670 million in flat-rate premiums and $787 million in variable-rate premiums for fiscal year 2005, and approximately $677 million in flat-rate premiums and $804 million in variable-rate premiums for fiscal year 2004.

Note 10 -- Losses from Completed and Probable Terminations

Amounts reported as losses are the present value of future benefits less related plan assets and the present value of expected recoveries from sponsors. The following table details the components that make up the losses:

LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS -- SINGLE-EMPLOYER PROGRAM

	For the Years Ended September 30,					
	2005			2004		
(Dollars in millions)	**New Terminations**	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$21,191**	**$(292)**	**$20,899**	$6,926	$(427)	$ 6,499
Less plan assets	**10,516**	**0**	**10,516**	3,137	125	3,262
Plan asset insufficiency	**10,675**	**(292)**	**10,383**	3,789	(552)	3,237
Less estimated recoveries	**9**	**(37)**	**(28)**	280	11	291
Subtotal	**$10,666**	**$(255)**	**10,411**	$3,509	$(563)	2,946
Settlements and judgments			**(1)**			1
Loss (credit) on probables			**(6,456)***			11,760 *
Total			**$ 3,954**			$14,707

* See Note 4

Note 11 -- Financial Income

The following table details the combined financial income by type of investment for both the single-employer and multiemployer programs:

Investment Income - Single-Employer and Multiemployer Programs

(Dollars in millions)	Single-Employer Program Sept 30, 2005	Multiemployer Program Sept 30, 2005	Memorandum Total Sept 30, 2005	Single-Employer Program Sept 30, 2004	Multiemployer Program Sept 30, 2004	Memorandum Total Sept 30, 2004
Fixed-income securities:						
Interest earned	**$1,270**	**$ 53**	**$1,323**	$ 858	$50	$ 908
Realized gain (loss)	**1,361**	**82**	**1,443**	(18)	(2)	(20)
Unrealized gain (loss)	**(876)**	**(56)**	**(932)**	143	6	149
Total fixed-income securities	**1,755**	**79**	**1,834**	983	54	1,037
Equity securities:						
Dividends earned	**81**	**0**	**81**	104	0	104
Realized gain	**1,540**	**0**	**1,540**	1,044	0	1,044
Unrealized gain	**493**	**0**	**493**	1,048	0	1,048
Total equity securities	**2,114**	**0**	**2,114**	2,196	0	2,196
Other income	**28**	**0**	**28**	18	0	18
Total investment income	**$3,897**	**$ 79**	**$3,976**	$3,197	$54	$3,251

Note 12 -- Employee Benefit Plans

All permanent full-time and part-time PBGC employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984, participate in CSRS unless they elected and qualified to transfer to FERS.

The Corporation's contribution to the CSRS plan for both 2005 and 2004 was 7.0 percent of base pay for those employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 10.7 percent of base pay for both 2005 and 2004. In addition, for FERS-covered employees, PBGC automatically contributes 1 percent of base pay to the employee's Thrift Savings account, matches the first 3 percent contributed by the employee and matches one-half of the next 2 percent contributed by the employee. Total retirement plan expenses amounted to $11 million in 2005 and $10 million in 2004.

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

Note 13 -- Cash Flows

The following two tables, one for Sales and one for Purchases, provide further details on cash flows from investment activity. Sales and purchases of investments are driven by the level of newly trusteed plans, the unique investment strategies implemented by PBGC's investment managers, and the varying capital market conditions in which they invest during the year. Several investment strategies in use in 2005 involved higher volume short term investments, particularly in the fixed income area, as shown in the Investing Activities table below. These cash flow numbers can vary significantly from year to year based on the fluctuation in these three variables.

INVESTING ACTIVITIES

(Dollars in millions)	September 30, 2005	2004
Proceeds from sales of investments:		
Fixed maturity securities	**$125,646**	$37,929
Equity securities	**8,515**	4,677
Other/uncategorized	**2,395**	2,993
Total	**$136,556**	$45,599
Payments for purchases of investments:		
Fixed maturity securities	**$(139,681)**	$(38,872)
Equity securities	**(7,022)**	(2,013)
Other/uncategorized	**5,156**	46
Total	**$(141,547)**	$(40,839)

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

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2005**	2004	**2005**	2004	**2005**	2004
Net income (loss)	**$ 529**	$(12,067)	**$(99)**	$25	**$ 430**	$(12,042)
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	**(2,481)**	(2,160)	**(26)**	(3)	**(2,507)**	(2,163)
Net gain of plans pending termination and trusteeship	**46**	(84)	**0**	0	**46**	(84)
Losses on completed and probable terminations	**3,954**	14,707	**0**	0	**3,954**	14,707
Actuarial charges	**490**	1,787	**0**	1	**490**	1,788
Benefit payments - trusteed plans	**(3,301)**	(2,888)	**(1)**	(1)	**(3,302)**	(2,889)
Settlements and judgments	**(5)**	(7)	**0**	0	**(5)**	(7)
Cash received from plans upon trusteeship	**218**	51	**0**	0	**218**	51
Receipts from sponsors/non-sponsors	**216**	84	**0**	0	**216**	84
Amortization of discounts/premiums	**128**	128	**11**	11	**139**	139
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
(Increase) decrease in receivables	**31**	(311)	**0**	3	**31**	(308)
Increase in present value of nonrecoverable future financial assistance			**190**	45	**190**	45
Increase (decrease) in unearned premiums	**(13)**	16	**0**	0	**(13)**	16
Increase (decrease) in accounts payable	**(1)**	12	**0**	0	**(1)**	12
Net cash provided (used) by operating activities	**$ (189)**	$ (732)	**$ 75**	$81	**$ (114)**	$ (651)

Note 14 -- Litigation

PBGC was involved in numerous litigation matters in 2005. At the end of the fiscal year, PBGC had 383 open, active bankruptcy cases and 45 active litigation matters (other than in bankruptcy court). PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. PBGC estimates that possible losses of up to $180 million (due primarily to new issues in active litigation) could be incurred in the event that PBGC does not prevail in these matters. These possible losses are not recognized in the financial statements.

Note 15 -- Subsequent Events

Changed business and financial conditions subsequent to September 30, 2005, will result in the PBGC adding plans to its probable or terminated inventory in the single-employer program in FY 2006. If these changed business and financial conditions had occurred prior to FY 2005 year-end, PBGC's financial statements would have reflected a decrease of $2.9 billion in Net income and a decrease in the Net position in the same amount.

There was no subsequent event to report on the multiemployer program.

Section V

Agency Comments

PBGC
Protecting America's Pensions
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

Office of the Executive Director

NOV -9 2005

TO: Robert L. Emmons, Inspector General

FROM: Bradley D. Belt BDB

SUBJECT: PBGC's Response to the FY 2005 and FY 2004 Financial Statements Audit Reports

We appreciate the opportunity to respond to the Fiscal Year 2005 financial statements audit reports prepared by Clifton Gunderson with the oversight of the PBGC Office of Inspector General (OIG). The Fiscal Year 2005 report marks the 13th consecutive year we have received an unqualified audit opinion on our financial statements. Our financial results again underscore the financial challenges facing PBGC, the threats to the long-term viability of the pension insurance program, and the need for comprehensive pension reforms to strengthen the retirement security of the 44 million Americans protected by PBGC.

We are pleased that the OIG and Clifton Gunderson recognized the improvements that the Corporation has made to improve our controls over the calculation and reporting of single and multiemployer plan contingent liabilities, which had been identified as reportable conditions last year. We also appreciate your recognition of the progress we have made on the three previous conditions which remain open and share your view as to the importance of the new condition you have opened.

PBGC agrees with the findings and recommendations underlying the four reportable conditions that were identified in the Report on Internal Control this year and is committed to addressing these matters in a timely manner to further improve our internal processes and systems. We provide comments relating to each reportable condition below:

- **Systems Integration** – While it is true that the reportable condition remains open, the groundwork has been laid for this condition to close out, perhaps with the implementation of our integrated general ledger system in the middle of next year. In 2005, PBGC structured a bid process for and then solicited and retained a system integration contractor to complete the consolidation of its financial systems and to perform Business Process Re-engineering (BPR) for increased integration between those systems and others in the corporation. The design is complete on standardizing data classifications and common data elements that will form the basis for that integration. The new accounting system that will replace the existing Performance Accounting, Trust Accounting, and Financial Reporting systems and their related interfaces is scheduled to go live at the end of

June 2006. The BPR and the design, development, and implementation work on related systems will be accomplished in phases with full implementation by the end of FY 2007.

- **Systems Security** – While this reportable condition too remains open from last year, changes implemented late in FY 2005 and scheduled for early in January FY 2006 should enable it to close out in FY 2006. PBGC's Office of Information Technology (OIT) has assigned resources to complete implementation efforts to update the general security plan and associated security policies to reflect the current operating environment and to complete the implementation of a fully functional and integrated enterprise-wide information security program. In addition, OIT has developed a high level control framework of risk assessment/evaluation, establishing a risk mitigation plan and long term strategy encompassing control objectives, control techniques, monitoring and periodic re-evaluations. This program was developed using industry standards such as COBIT, NIST, applicable OMB circulars, etc. The compliance mechanisms will ensure that all major systems comply with the enterprise-wide information security program and ensure that policies and procedures for access to and security of information resources are consistently applied. PBGC expects to complete work on a significant number, if not all, of the recommendations underlying this reportable condition during FY 2006.

- **Premiums** – This condition remains open from 2004 as a result of the removal of the implementation contractor in 2005. Though the project has retrenched with assignment of detailed design responsibility to another contractor, progress on data quality and suspense item controls has been made with the new data capture contractor and image capture systems and with new manual controls. PBGC's Financial Operations Department has made considerable progress in addressing recommendations underlying this area, and expects that the implementation of the Premium Practitioner System in January 2007 will complete remaining open aspects of this reportable condition such that they can be removed. The new system is designed to improve timeliness and accuracy in premium operations in order to strengthen financial management and customer service and will be supplemented with comprehensive documentation of procedures for processing and estimating premiums.

- **Continuity of Operations** – PBGC has a current Continuity of Operations Plan (COOP) that outlines specific actions to ensure completion of identified essential functions for an interim period of up to 30 days. The PBGC COOP Plan was prepared using the guidance from Federal Preparedness Circular 65 issued by the Federal Emergency Management Agency in June 2004. The OIG and Clifton Gunderson have properly defined an expanded scope for contingency planning for the agency to include COOP, Devolution Planning, and Reconstitution Planning. PBGC did experience a computer failure that occurred in late September 2005 disrupting the use of PBGC network drives and electronic mail systems and concurs that this experience exposed weaknesses in our pre-defined response and remediation procedures. PBGC has hired an outside consultant to assist management in determining the root causes of this disruption and identifying appropriate changes to our existing COOP and contingency planning processes to make them more responsive to different types of resource or service disruptions. We also expect to run more rigorous readiness tests to confirm the results of those efforts. We expect that these recommendations should be addressed during FY 2006.

We very much appreciate the work of the OIG and Clifton Gunderson to complete a complex audit within the 45-day period specified in the President's Management Agenda, and we look forward to continue to proactively work with you in ensuring that PBGC controls are operating effectively. Again, thank you for the opportunity to respond.