



KNOWLEDGE WILL FOREVER
GOVERN IGNORANCE:
AND A PEOPLE WHO MEAN
TO BE THEIR OWN GOVERNOURS,
MUST ARM THEMSELVES
WITH THE POWER
WHICH KNOWLEDGE GIVES.

James Madison

Pension Benefit Guaranty Corporation
Office of Inspector General
Semiannual Report to Congress
April 1, 2006 - September 30, 2006

Mission

The Office of Inspector General is an independent and objective voice that helps Congress, the Board of Directors and PBGC protect the pension benefits of American workers by promoting positive change, accountability and Integrity

Vision

We will be recognized by our stakeholders as the primary source of objective & independent information for their key decisions

Values

Respect

We will treat others as we would like them to treat us

Integrity

We will be a role model of ethical behavior

Excellence

We will constantly innovate & improve the quality and value of our work



Pension Benefit Guaranty Corporation

Office of Inspector General

1200 K Street, NW, Washington, DC 20005-4026

October 31, 2006

The Honorable Elaine Chao
Chairman, PBGC Board of Directors

On behalf of the Office of Inspector General for the Pension Benefit Guaranty Corporation, I am pleased to submit this Semiannual Report to the U.S. Congress for the 6-month period ending September 30, 2006. It details our efforts to improve the economy and efficiency of PBGC operations, our efforts to prevent fraud, waste and misconduct, and fulfills our reporting requirements under the Inspector General Act.

I am pleased to report that PBGC made considerable progress in addressing conditions reported in previous semiannual reports. The Chief Financial Officer's continuing initiative to assign accountability and aggressively oversee corrective actions for audit recommendations has resulted in a renewed commitment to resolving long standing problems. Notably, PBGC will use a newly implemented consolidated financial system to prepare next year's financial statements. I am hopeful the new system will help PBGC resolve the reportable condition related to integrating financial systems we have reported for several years.

During this semiannual period, we issued two significant reports that highlight the unique nature of PBGC – a self-financing corporation doing business in the complex financial world, while also a federal government entity charged with protecting and using trust funds to pay retirees' benefits and finance its operations.

- Increasingly, PBGC is involved in bankruptcies where a significant equity stake in the reorganized company is received for unfunded pension liabilities. In the first report, we evaluated PBGC's sale of a major stock claim to determine if PBGC's actions were reasonable in light of industry standards for institutional investors. We concluded that PBGC needs an over-arching policy and internal procedures that delineate authorities and responsibilities for acquisition and sale of such claims.
- In the second report, we disclosed to the Board and Congress that \$7 million included in PBGC's FY 2007 budget request was a disproportionate share of development costs for a new electronic filing system used by several government agencies. In addition, we observed that earmark language in PBGC's appropriation to fund the system sets a precedent for using PBGC trust funds to supplement appropriations of other federal agencies.

Our investigative unit's work centered on employee integrity, fraudulent claims, protecting the pension benefits of participants and safeguarding PBGC assets. PBGC management is using our investigative reports to discipline employees with integrity violations, and we obtained a conviction of an individual involved in an identity and pension check theft scheme. Our investigators engaged

in activities to improve controls and deter fraud, including the Assistant IG for Investigations participating as a non-voting member on the agency's Internal Control Committee, and issuing a management advisory alerting management to control weaknesses uncovered in an investigation. We will continue to collaborate with the Office of the General Counsel to strengthen the ethical environment here at PBGC.

As a strong champion of pension reform, you know that the Pension Protection Act of 2006, passed in August 2006, is the most comprehensive legislation enacted since PBGC was established in 1974. The Act touches virtually every aspect of PBGC's financial operations and the Deficit Reduction Act provides a much needed increase in premium revenues. This should improve the Corporation's financial position, but the long-term impact on PBGC's continuing deficit is uncertain. We will closely monitor the impact of the legislation on PBGC's financial position.

I want to acknowledge the extraordinary efforts of our staff, and thank them for their dedication to duty and accomplishments. I am gratified by the continued support of our work and the spirit of cooperation with PBGC and the Board. We are proud to be part of an organization that protects the pensions of over 44 million Americans, and will constantly strive to keep its programs efficient, effective and free from fraud, waste and abuse.

Robert L. Emmons
Inspector General

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Executive Summary

This Semiannual Report to Congress summarizes the activities and accomplishments of the Pension Benefit Guaranty Corporation (PBGC) Office of Inspector General (OIG) for the period April 1, 2005, through September 30, 2006. When accomplishing audit and investigative work, we ensure that it accords with our mission to be an “independent and objective voice for Congress, the Board of Directors, and PBGC.” We want to focus our work on the challenges facing PBGC and to be the primary source of timely and objective information for the organization. We will accomplish our work demonstrating our values of respect, excellence, and integrity.

We conducted work in all areas designated as management challenges, including:

- Governance— our evaluation of PBGC’s actions in marketing and selling a significant claim to stock that it obtained in a reorganized private sector business resulted in recommendations to establish policy, internal guidance regarding responsibilities, and standard documentation for such dispositions (see page 5).
- Program performance—our audit concluded that the \$7 million proposed expenditure in PBGC’s FY2007 budget for developing of a system jointly used by several federal agencies was disproportionate, and we responded to a Congressional request concerning PBGC’s proportional share (see page 6).
- Financial management— in monitoring and facilitating the work of our financial statement audit contractor, we evaluated substantive statutory and regulatory changes impacting the financial statements and participated in regular meetings with the Chief Financial Officer and financial operations staff (see page 8).
- Information technology — our FISMA report noted significant information security improvements but continued to highlight a concern about systems certification and accreditation; and our evaluation of PBGC’s use and distribution of Blackberry devices recommended that PBGC develop distribution and cost-management policy. (see page 11 and 13).
- Procurement and contracting—we questioned costs in audits of a contractor’s termination proposal and its incurred costs prior to termination for a significant IT development contract that PBGC terminated (see page 11).

In the investigative area, we opened 11 new cases, and closed 16 cases and 10 inquiries. Significant investigative work this period included:

- finding a PBGC manager was using PBGC resources to operate a travel business, soliciting and arranging travel for PBGC employees, contractors and external individuals (see page 19)
- obtaining an indictment and conviction of one participant in a multi-state fraud scheme to steal the identity of “missing participants” and obtain pension checks ranging from \$4,000 to \$21,000 (see page 20); and
- issuing a management advisory regarding internal control vulnerabilities we found while investigating fraud in the Missing Participants program. (see page 21).

OIG staff participated in many internal and external activities, including as non-voting members of PBGC oversight committees, PBGC mentoring and tutoring programs, IG community initiatives, and external professional organizations.

Two significant reports highlight the unique nature of PBGC

Introduction

The Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC, or the Corporation) was established under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. §§ 1301-1461), as a self-financing, wholly owned federal government Corporation to administer the pension insurance program. ERISA requires that PBGC: (1) encourage the continuation and maintenance of voluntary private pension plans, (2) provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries, and (3) maintain premiums at the lowest level consistent with carrying out PBGC's obligations.

For about 44 million Americans, PBGC provides assurance that their retirement benefits will be paid, up to a statutory limit. PBGC protects the pensions of participants in certain defined benefit pension plans (i.e., plans that promise to pay definitely determinable retirement benefits). Such defined benefit pension plans may be sponsored individually or jointly by employers and unions. PBGC is now responsible for the pensions of about 1.3 million people, including about 600,000 who will receive benefits when they retire in the future. PBGC pays about \$370 million a month to about 700,000 current retirees.

The Office of Inspector General

The mission of the Office of Inspector General (OIG) is to be an independent and objective voice that helps the Congress, the Board of Directors, and PBGC protect the pension benefits of American workers by promoting positive change, accountability, and integrity. To accomplish our mission, the OIG conducts agency audits, inspections, and investigations to provide our stakeholders with information they need to make decisions.

This period, we had some exciting changes:

- moving into new office space we designed to meet our needs, that includes team rooms, permanent workstation space for our contractors, and maximum natural light for staff.
- welcoming five new staff members, including a financial audit manager, a forensic auditor, and three staff auditors. Of our 22 authorized positions, we are currently recruiting to fill one position.

To provide value, we focus our work on the challenges that PBGC is facing, whether we are issuing audits, evaluations and investigative reports, or consulting with PBGC and participating on various teams and in working groups. We are committed to our values of respect, excellence, and integrity in all we do.

Our approach to audit planning concentrates our efforts on identifying issues that are important to PBGC. We maintain an inventory of suggested audits that we receive from

Each month, PBGC pays about \$370 million in pension benefits to about 700,000 retirees.

OIG moved into new space and welcomed five new staff

IG uses input from stakeholders to plan audits and investigations.

a variety of sources, including the Board of Directors and PBGC management. Each year, we assess risk in terms of materiality, impact on operations, and potential for adverse publicity for the Corporation. Based on this risk assessment, we identify the most important challenges on which to focus our work. The final step is to plan and conduct audits that address those challenges. We continue to focus on these major questions:

- Does PBGC have a governance model that ensures reliable and complete financial reporting, effective customer service, and ethical business dealings?
- Does PBGC have strong financial controls that are needed to protect assets and minimize costs?
- Does PBGC effectively balance operational efficiency with optimal customer service?
- Do PBGC contractors provide quality products and services at a reasonable price?
- Do PBGC's information systems maximize customer service while protecting the privacy and integrity of information?

We have scheduled audits and reviews in 2007 to address each of these challenges.

As required by the Chief Financial Officers Act, we continue to audit PBGC's financial statements. The OIG contracts with an independent public accountant to perform this work.

In our attempt to maximize limited resources, our approach to investigations is to apply strict criteria in evaluating the quality of the allegations received. For example, we evaluate allegations against the potential criminal and civil violations, the statute of limitations, the potential for negative publicity for PBGC, and the total assets involved. This allows us to concentrate on investigative issues that are most important to PBGC.

The OIG follows the standards contained in the *Quality Standards for Federal Offices of Inspector General*, published by the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). These standards require audits to be conducted in accordance with Government Auditing Standards, issued by the Government Accountability Office. Our investigations comply with *Quality Standards for Investigations*, which have been accepted by the PCIE and ECIE.

Audits and Evaluations

Overview

Our approach is to focus our audits and evaluations on areas that present significant management challenges to PBGC. Using our past work and input from the Board of Directors and management, we conducted work this semiannual period to address governance, program performance, financial management, information technology, and procurement and contracts issues. The OIG staff participated on corporate-wide teams addressing various issues of joint concern. Our goal is to have a positive impact on the decision-making process of the Board of Directors and PBGC management.

1. Governance

Governance is a major challenge of the Corporation, particularly as it struggles with a growing deficit and record numbers of terminated pension plans and participants. Oversight of the financial operations and financial reporting by the Board of Directors, PBGC management and the OIG is critical to effective corporate governance. Equally important is the ethical tone set by PBGC leaders as we conduct our business.

[Review of PBGC Claims Sale \(2006-11/PA-0029\)](#)

We engaged an independent investment advisory firm to evaluate whether PBGC's actions in marketing and selling its claim to stock in a reorganized company prior to its emergence from bankruptcy was reasonable in light of PBGC's governance and industry standards for institutional investors. PBGC has, and is likely to continue to have, unsecured claims against bankrupt pension plan sponsors arising out of plan terminations. PBGC's claims may result in the federal government's right to receive a significant equity stake in a reorganized private sector business. Thus, PBGC needs an over-arching policy and internal procedures that delineate authorities and responsibilities for acquisition and sale of such securities. The policy and internal guidance should address, for example, communication between the Board and PBGC about such transactions, and consultations among PBGC departments at key points.

As a result of the evaluation, we recommended that PBGC develop:

- policies and procedures with respect to the disposition of bankruptcy claims;
- governance documents to clearly set out responsibilities for such dispositions, and
- standard documentation for claims sales.

PBGC agreed with our findings and recommendations, and will be reporting their implementation progress to the OIG in February 2007.

Because this report contains confidential business information, the report is not publicly available.

***PBGC bankruptcy
claims may result
in a significant
equity stake in
a reorganized
private-sector
business***

Pension Protection Act of 2006

With the passage of the Pension Protection Act of 2006, Title IV of ERISA was amended to add a Presidentially-appointed and Senate confirmed “Director” who is responsible for administering PBGC in accordance with policies established by the Board. In the coming months, we will monitor the governance implications of this provision. The Act does not change OIG’s reporting relationship to the PBGC Board of Directors, which provides a critical role in setting policy and overseeing PBGC.

We will continue to work with the Board and management for a governance model that ensures reliable and complete financial reporting, effective customer service, and ethical business dealings.

2. Program Performance

Significant OIG resources this period were devoted to auditing whether PBGC was being required to pay a disproportionate share of the development costs of a new electronic filing system that the Department of Labor is developing. PBGC was directed to request \$7 million (M) in its FY2007 budget request to pay for about half of the development costs of EFAST2. This audit raised questions that impacted the budget process as well as PBGC’s governance structure. For example, when Congress established PBGC as a government corporation, what role did it envision for the Department of Labor (DOL) in overseeing and directing expenditures of PBGC trust funds?

Audit of FY2007 EFAST2 Development Costs (2006-12/PA-0026)

In October 2005, OIG expressed concern about DOL directing PBGC to include \$7M in its FY2007 budget request to fund a disproportionate share of the ERISA Filing Acceptance System (EFAST2) development costs. DOL is developing EFAST2 with two partnering agencies, the Internal Revenue Service (IRS) and PBGC. IRS is a significant user of EFAST information (the current system), but they are not funding any of the EFAST2 development costs. Our audit was to determine if PBGC’s funding for EFAST2 is disproportionate and, if so, to ensure that policy makers (Congress, the PBGC Board of Directors, and in particular the Department of Treasury) were fully informed regarding this issue.

EFAST2 will be a new, fully-electronic system to file the Form 5500. Among other things, the Form 5500 is used by partnering agencies DOL, IRS and PBGC to obtain critical information about pension plans for which they have oversight and enforcement responsibilities. The EFAST2 development costs for FY2007 are approximately \$14.5M.

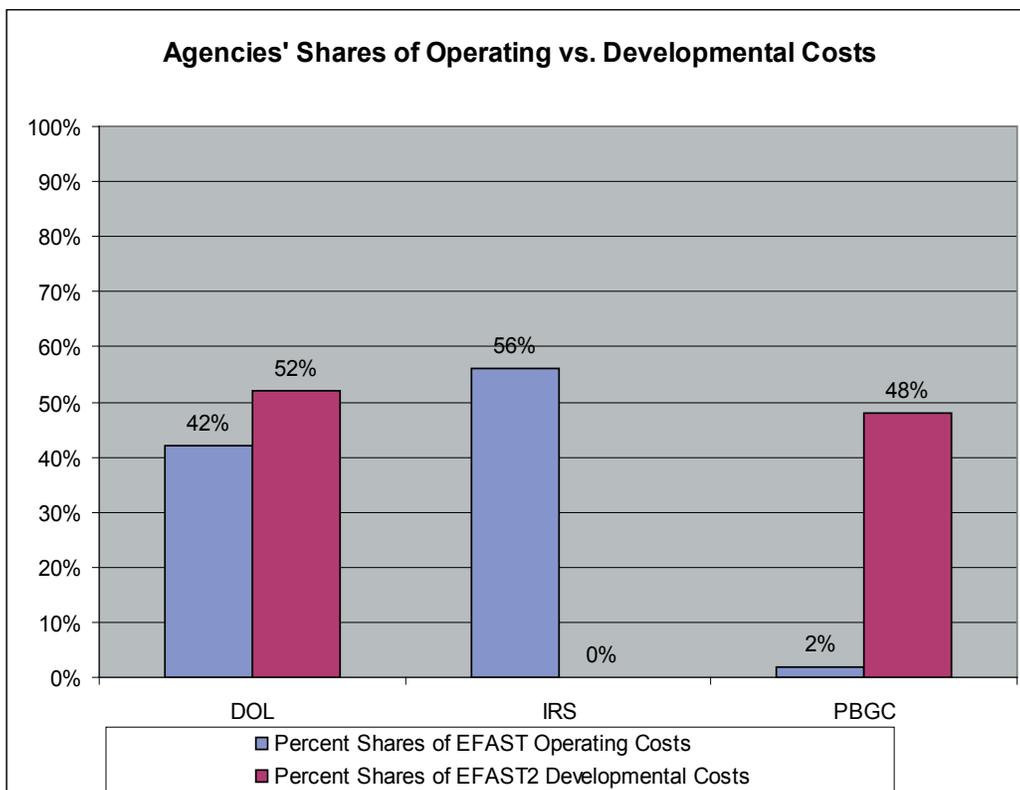
Our audit found that DOL had originally planned to fund the entire EFAST2 development costs. In August 2005, however, without consulting the partnering agencies, DOL prepared a budget document that assessed FY2007 development costs

*Our EFAST2 report informed
the Board and Congress of
disproportionate
cost-sharing*

to the partnering agencies: PBGC \$500,000, DOL \$7M and IRS \$7M. When the IRS could not contribute to the development costs so late in the FY2007 budget process, in October 2005, the Office of Management and Budget (OMB) and DOL assessed an additional \$6.5M to PBGC’s FY2007 budget through the budget passback process.

After the Inspector General (IG) and PBGC raised concerns about disproportionate funding, DOL drafted “earmark” language for PBGC’s FY2007 appropriation that requires PBGC to transfer \$7M to DOL for EFAST2’s development.

OIG concluded that PBGC’s share of EFAST2 development costs for FY2007 is not proportionate to the partnering agencies. If PBGC pays \$7M, it will be paying 48% of the FY2007 EFAST2 development costs while IRS, a major user of the systems, pays none of the development costs. Historically, DOL has assessed the partnering agencies a share of the operating costs (not development costs) based on their use. This resulted in PBGC paying about 2%, IRS paying about 55%, and DOL paying about 42%. During the audit, DOL suggested alternate methods for computing “use,” however we noted that these methods had not been disclosed to PBGC or IRS for verification of the proportional use attributed to them.



We confirmed that Congressional appropriations and oversight committees and PBGC’s Board of Directors were not fully informed of the issues we raised, including the risks of disproportionate funding. We issued this report to fully disclose our findings and conclusions to decision-makers before Congress approved PBGC’s FY2007 budget request. We believe that earmarking the \$7M in PBGC’s budget sets a precedent for using PBGC trust funds to supplement the appropriations of other federal agencies.

Earmarking trust funds could set a precedent for supplementing appropriated funds

Congressional Request

After we briefed the House Appropriations subcommittee with responsibility for the DOL and PBGC budgets on our report’s conclusion, we were asked to provide an estimate of PBGC’s proportional share of EFAST2 development costs. In our response, we noted it is best that PBGC trust fund expenditures go through the normal budget process and controls. We also indicated that earmarking funding for EFAST2 could set a precedent for others to suggest earmarks to PBGC’s trust fund in the future. If the three partnering agencies (DOL, IRS, and PBGC) agreed to share a proportional share of the EFAST2 development costs there would be no need for an earmark.

Based on available data, we told the subcommittee that we believe PBGC’s share of EFAST2 development costs could range from \$500,000 to \$3.6M. We also said no information provided by DOL or PBGC would support PBGC paying \$7M as earmarked in the House Appropriations’ bill. Finally, we believe DOL should initiate cost-sharing discussions with the partnering agencies and develop a transparent agreement that shares costs proportionally and is mutually agreeable.

3. Financial Management

PBGC is a significant government entity that managed over \$57 billion in assets and paid approximately \$3.7 billion in benefit payments to retirees during FY2005. As of September 30, 2005, the single-employer and multiemployer programs reported net deficit positions of approximately \$22.8 billion and \$335 million, respectively. This was a slight improvement over FY2004, in which PBGC reported the largest deficit in its 30-year history of more than \$23 billion. We anticipate that when the FY2006 financial statements are published, they will also show an improvement over the FY2005 results.

PBGC currently has sufficient assets to pay participants guaranteed benefits for a number of years, but neither of its insurance programs has sufficient assets to satisfy all of the benefit obligations already incurred, much less future obligations likely to be assumed. However, this risk is temporarily deferred, as the universe of deferred vested participants will retire over many years, not all at once.

In September 2005, the Congressional Budget Office estimated that the present value of PBGC’s net costs for defined pension insurance for single-employer plans over the next 10 years is about \$86.7 billion. That total consists of two distinct components: \$23.3 billion of losses from insurance claims for plans that have already terminated or whose termination is imminent, and \$63.4 billion of prospective losses over the next 10 years for terminations that have not yet occurred, net of future premiums. Total costs for 15- and 20-year horizons are \$119 billion and \$141.9 billion, respectively. PBGC anticipates that the Pension Protection Act will have a negative impact on these estimates in the medium to long-term timeframe, since funding requirements will be more stringent under the Act, and accounting for defined benefit pension plans is changing. However, the extent of PBGC’s future losses is not yet known.

PBGC continues to owe billions more in benefits that it has funds to pay

For these reasons, strong financial management controls are needed to protect the existing assets and minimize current and future costs. The OIG continues to focus a large portion of its work on financial management and performance (economy and efficiency) issues to help PBGC address these challenges. Given the importance of this work, the OIG recently hired and designated separate managers to oversee the financial management and performance audit and advisory work.

Recent Statutory and Policy Changes affecting Financial Management

Several recent statutory and policy changes will have a major impact on PBGC financial operations.

Deficit Reduction Act of 2005

Employers who sponsor defined benefit plans must pay premiums to PBGC for each participant in the plan. The Deficit Reduction Act of 2005 increased PBGC's per participant flat premium rates and provided an annual inflation adjustment. This should result in a significant increase in PBGC's premium revenues. Effective for plan year 2006, flat rate premiums increased:

- for single-employer plans, from \$19 to \$30, and
- for multiemployer plans, from \$2.60 to \$8.00.

For single-employer plans in plan year 2007, PBGC has announced the flat premium rate will increase to \$31 per participant. The Act also added a new premium charge for certain terminated single-employer plans and a special rule for plans terminated in bankruptcy reorganizations.

Pension Protection Act of 2006

The Pension Protection Act of 2006 is the most comprehensive pension reform legislation since ERISA was enacted in 1974 and impacts virtually every aspect of PBGC's financial management. The provisions that most directly affect PBGC can be categorized under:

- Funding requirements
- Benefit restrictions
- PBGC premiums
- Multiemployer plans
- Cash balance plans
- Disclosure provisions
- Miscellaneous provisions including expanding PBGC's missing participant program.

We are currently evaluating the impact of the legislation on PBGC's financial management. Most of the provisions will be effective in 2008 or later years.

The Deficit Reduction Act provided a much-needed increase in premium revenues

In updated guidance, OMB requires a draft annual management report by November 1

Office of Management and Budget Guidance

Circular A-136, Financial Reporting Requirements: In conjunction with the Chief Financial Officers (CFO) Council, OMB updated existing guidance relating to agency and government-wide financial reporting. The two sections that specifically apply to PBGC are: Section I.5, Submission Deadlines, and Section V. Government-Wide Financial Report. Section I.5 makes permanent the requirement that Government Corporations submit their Annual Management Reports no later than 45 days after the end of the fiscal year. PBGC should also submit to OMB a draft Annual Management Report ten working days before the final Annual Management Report is issued.

The Department of the Treasury (Treasury) prepares the Financial Report of the United States Government (FR) from data provided by Federal entities. PBGC is one of the entities that reports information to the Treasury to support the FR as specified in Section V of the Circular. PBGC prepares a Closing Package, including special-purpose financial statements, and submits them to Treasury through the Government-wide Financial Report System. The special-purpose financial statements directly link PBGC's audited financial statements to the FR.

OMB Bulletin 06-03, Audit Requirements for Federal Financial Statements: On August 23, 2006, OMB issued these minimum requirements for audits of Federal financial statements. The bulletin is effective immediately and applies to the audits of government corporations. Audit reports must be submitted to PBGC's Interim Director in sufficient time to enable PBGC to meet the November 15, 2006 deadline for submission of audited financial statements.

Ongoing Risk Assessments Affecting Financial Management

The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish and maintain effective internal control. PBGC management is currently performing an entity-wide risk assessment as part of PBGC's compliance with FMFIA. PBGC is using its FY 2005 risk assessment as a baseline and is considering new or changing factors in PBGC's internal and external environment that may affect its risks. For example, last year's risk assessment included the need for new legislation. With the passage of the Pension Protection Act of 2006, related risks will change.

Audit of PBGC's FY 2006 Financial Statements

In accordance with the IG Act of 1978 and the Government Corporations Control Act of 1945, the IG has contracted Clifton Gunderson LLP (CG) to conduct the audit of PBGC's FY 2006 financial statements. This audit will be conducted in accordance with Government Auditing Standards, U.S. Generally Accepted Auditing Standards, and the GAO Financial Audit Manual.

CG will issue three separate audit reports, which will be published on November 15, 2006, in relation to the audit of PBGC's financial statements:

- (1) an opinion on the financial statements,
- (2) an opinion on management's assertion on the effectiveness of internal controls over financial reporting and compliance with applicable laws and regulations; and
- (3) a report on compliance with applicable laws and regulations.

CG will also opine on the special-purpose financial statements discussed in OMB Circular A-136.

CG will issue a management letter, if less significant weaknesses in internal controls or less significant issues of non-compliance with applicable laws and regulations are identified as part of the audit. The reports will also present the status of prior year audit findings, which will be reflected in the next OIG Semiannual Report.

CG may also perform agreed-upon procedures for federal intragovernmental activity and balances if Treasury disseminates differences in balances to PBGC's CFO and IG.

Maintaining and improving communication is very important to the OIG, CG, and CFO. In early April, the OIG and CG held an entrance conference to kick off this year's audit. CG and the OIG are working closely with the CFO to coordinate and facilitate receiving the documents and items needed by the auditors for testing. CG and OIG auditors meet regularly with the CFO and other PBGC management officials to discuss the status of the audit, including any potential or confirmed significant issues and audit findings.

The CFO also invited the auditors to participate in periodic meetings to discuss and understand PBGC's interim (quarterly) financial statements for the periods ending March 31 and June 30, 2006. This has provided CG and the OIG with an opportunity to understand interim results and identify issues early in the process.

CG's preliminary draft report on internal controls was provided to management on September 18, 2006. This continues our emphasis on accelerating the issuance of the preliminary draft report to management and is four months earlier than the date the draft report on the FY 2002 audit was provided to management.

PBGC continues to take steps to address the following four reportable conditions identified in the FY 2005 Report on Internal Control: financial management systems integration, information security, single-employer premiums, and preparedness for unanticipated incidences and disruptions. CG has been assessing the actions taken by PBGC to correct and/or mitigate the reportable conditions, and has tentatively found that some progress has been made in each case.

OIG and financial auditors attend the CFO's quarterly close meetings to identify issues early in audit

4. Information Technology

Protecting the privacy and integrity of customer information is a major challenge for PBGC. The OIG continues to perform work to assist the Corporation in meeting this challenge.

Federal Information Security Management Act Report

PBGC continues to improve its system security infrastructure and posture in compliance with the Federal Information Security Management Act (FISMA) of 2002, as reported to OMB. During FY 2006, PBGC continued to take significant steps to identify levels of security required to control and protect its assets and information, and further improve its security program. The following are examples of the progress at PBGC:

- Improved security of the information systems and networks used by PBGC through new technologies, more restrictive Internet Protocol routing, systems integrity monitoring, and remotely monitored security incident detection.
- Implemented standardized system and application patches and security update procedures for all major business systems and general support systems.
- Identified the need to create a robust risk management and security program to close out existing audit findings related to information security.
- Began planning role-based training for all staff members based on current and upcoming guidelines; completion planned for FY 2007 pending additional funding.

For the past several years PBGC's information security internal controls and operational conditions was a reportable condition and continues as such today. Although PBGC is making progress in some areas related to information security, enhanced efforts are needed in the areas of organizational responsibility and authority, policy development and implementation, risk assessment and mitigation, and physical security controls.

Certification and accreditation of major business and general support systems continues to be a major area of concern. We have previously reported this issue in our FISMA report and continued this year, as OMB increases its focus on this aspect of information security. PBGC has begun to develop and implement a plan to recertify and accredit all of its major business and general support systems following the determination by the OIG's independent auditors that previous certifications and accreditations needed improvements.

Additionally, PBGC intends to identify and improve its adherence to other requirements and guidance such as the National Institute of Standards and Technology (NIST) Special Publications 800-37 *Guide for the Security Certification and Accreditation of Federal Information Systems*, NIST 800-53 *Recommended Security Controls for Federal Information Systems*, Federal Information Processing Standards Publication (FIPS) 199 *Standards for Security Categorization of Federal Information and Information Systems* and FIPS 200 *Minimum Security Requirements for Federal*

PBGC improves systems security, however, certification and accreditation remain a concern

Information and Information Systems.

Consolidated Financial System Project

We are encouraged that management continues its work on another reportable condition: to integrate its financial systems to improve operational efficiency and effectiveness as well as data security. PBGC made significant progress on the Consolidated Financial Systems project in FY 2006. The general ledger consolidation is complete and in use as the system of record beginning on October 1, 2006. The second round of business process reengineering is targeted for completion by mid-FY 2007.

Continuity of Operations

PBGC continues its efforts to prepare for an unexpected interruption to its normal business activities with both improvements to its Continuity of Operations Plan (COOP) and the development of a more encompassing Contingency Plan. During fiscal year 2006, PBGC conducted one major test of its COOP and participated in the Government-wide Forward Challenge 06 (FC06) event. During the COOP test, employees and management assembled at a backup operations site and connected to the backup computer systems located in another part of the country to process transactions and system operations. During the FC06 event, PBGC exercised all components of its recovery plan, including the notification process. OIG staff participated in both exercises, either as participants or as observers.

Although all tests were not completely successful, the goal is to identify the problems during testing and implement corrective actions to eliminate those problems. Future testing then concentrates on these areas to validate that corrections have been implemented and are working properly.

The OIG will continue to monitor PBGC's testing and provide feedback to management to help achieve their goal of having a reliable plan for recovery of operations in the event of a disaster or emergency situation.

Security Evaluation of Personally Identifiable Information

The OIG participated in the IG community's program to gather information on PBGC's initiatives to comply with OMB's Memorandum 06-16, *Protection of Sensitive Agency Information*, dated June 23, 2006. All information was documented in an assessment template and compiled into a consolidated report from all IGs. The results of our assessment noted that PBGC has taken steps to address all or part of three of the four recommendations for securing sensitive information. For the remaining items, PBGC has identified responsible parties to develop plans to fully comply.

Implementing a consolidated general ledger system addresses a long-standing reportable condition

Policies and procedures needed for distributing, using and managing costs of Blackberry devices

Management Practices in the Use and Distribution of Blackberry Devices (2006-13/IT-0021)

The OIG completed a review of how Blackberry technology is purchased, distributed, and controlled in PBGC. The overall purpose of this review was to determine if PBGC had established adequate policies and procedures to manage the use and distribution of Blackberry devices, and if so, were the procedures being followed.

Based on our review, we determined that there was no:

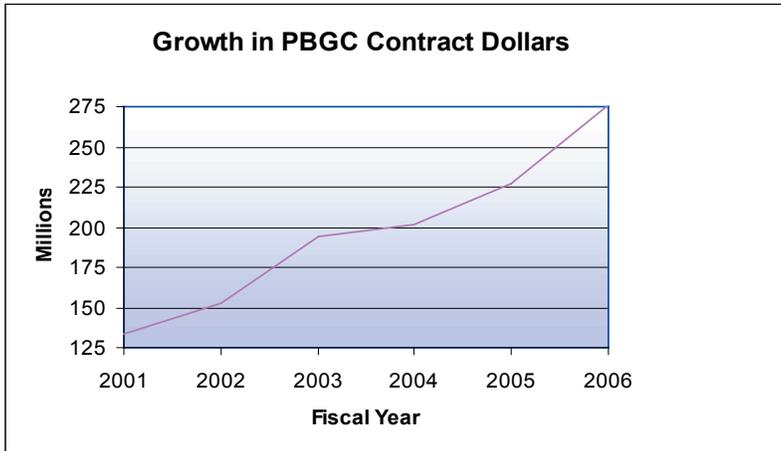
- formal policy for the distribution and use of Blackberry devices and associated services.
- standard practice that PBGC offices are required to follow.
- consistency in the services provided, the associated costs, and who pays.
- overall standard procedure and process for managers to use in making these decisions. This is of greater concern when PBGC provides contractors with a Blackberry because we may be increasing work and costs not covered in the contract.
- transparency to allow for proper management of the costs and use of Blackberry services within PBGC. Therefore, it is possible PBGC is paying for more services than it really should or needs.

To correct this situation, we recommended that PBGC establish an overall policy and procedures to address: who should receive a Blackberry; whether the service is paid by PBGC, an individual department, or a contractor; what specific services are required and received; and how costs and use will be better managed. Management agreed to our recommendations and has targeted corrective action to be implemented by March 31, 2007.

5. Procurement and Contracting

Several factors make contract management a major management challenge at PBGC:

- the contracting activity has more than doubled from 2001 to 2006;
- the Corporation spends more than 60 percent of its annual budget through contracts, exclusive of contracts for office space rent.
- the large number of labor hour contracts and the relatively low number of fixed price contracts: in FY2006, 55% were labor hour versus 22% fixed price.
- limited progress by the Procurement Department to collect questioned costs or settle costs through negotiation (see Appendix, page 26, Reports Issued With Questioned Costs and Funds Put to Better Use).



We continue to address this management challenge by conducting audits of PBGC contractors. Overall, the work we do in this area is designed to:

- Identify improvements to PBGC’s procurement process; and
- Verify that contractor billings were allowable, reasonable, supported and consistent with the terms of contracts.

Examination of Contract Termination Proposal for PBGC Contractor (2006-14/CA-0013)

PBGC terminated a significant information technology (IT) development contract for convenience of the government. We contracted with the Defense Contract Audit Agency (DCAA) to examine the termination settlement proposal and related cost or pricing data to determine if the proposed costs are acceptable as a basis for negotiation.

The contractor initially submitted a termination settlement proposal of \$293,170. Upon examination, DCAA found inadequacies that resulted in the contractor submitting a revised termination settlement of \$201,725. DCAA questioned \$197,035 or 98% of the \$201,725 because:

- \$195,756 of the proposed costs related to idle time rather than effort to complete tasks under the terminated contract, and
- Other questioned costs of \$1,279.

The OIG recommended corrective actions including determining the allowability of the questioned costs (\$197,035) and reducing potential contract termination payments.

**Questioned costs:
98% of contractor’s
termination proposal**

Incurred Cost Audit of PBGC Contractor (2006-16/CA-0013)

We contracted with the DCAA to conduct an audit of incurred costs on the IT development contract terminated for convenience (referenced above) to determine the allowability, allocability, and reasonableness of the contractor's billings.

DCAA examined the claimed contract amount of \$3,063,235. DCAA found inadequacies that resulted in the contractor submitting a revised submission for \$3,006,642. DCAA's review uncovered \$146,628 in questioned costs as follows:

Voluntary Deletion	\$ 56,593
Purchased Services	44,974
Facilities	39,044
G&A	4,987
Purchase Burden	<u>1,030</u>
	\$146,628

DCAA questioned \$44,974 in Purchased Services as unreasonable compensation. The subcontractor billed higher rates than were in their subcontract agreements. Also, no consultant or subcontract agreement was provided for an employee.

DCAA further questioned \$39,044 in Facility Costs that were not allocable to the contract. DCAA found the contractor claimed facilities costs as if all direct labor was performed at the contractor's controlled office space location (there are five different locations) when, based on the contract's terms and conditions, all work was to be performed at PBGC customer-site location.

The OIG recommended corrective actions including a determination of the allowability of the questioned costs (\$146,628) and initiation of necessary collection actions.

Consultations to Improve Process

During this period, we raised contracting concerns with PBGC management, including:

- using labor-hour contracts in circumstances in which fixed price contracts are appropriate;
- re-using statements of work for successor procurements without updating them, for example, to ensure work is well-described, staff qualifications are accurate, and prospective bidders are permitted to propose cost-saving operating methodologies to perform the work; and
- developing performance metrics for contractor performance.

Based on our consultation, PBGC withdrew a request for proposal and is re-evaluating the procurement.

We also offered to consult with procurement officials in their efforts to update and develop policies and procedures, which was a finding in prior audit reports.

Work in Process

Under a firm fixed price contract, we hired an Independent Public Accountant to examine a contractor's cost representations as presented in their invoices for services performed for FYs 2003 - 2005. Through September 30, 2005, the contract had been amended 14 times and the total amount obligated was more than \$29 million.

Access to Information

Under the Inspector General Act, the Inspector General is to have unfettered access to all agency records, information, or assistance when engaged in an investigation or audit. Whenever access to requested records, information, or assistance is unreasonably refused or not provided, the Inspector General must promptly report the denial to the agency head.

During this six month reporting period, the Inspector General's access to information was not restricted.

Management Decisions

The Inspector General is required to report the following about management decisions on audit reports that occurred during this six-month period:

- There were no audit reports for which there was not a management decision.
- There were no significant revised management decisions.
- There were no management decisions with which the Inspector General disagreed.

Investigations

Overview

A major responsibility of the OIG is to receive and investigate complaints from PBGC employees, the public, and other sources concerning violations of law, rule, or regulation; mismanagement; gross waste of funds; abuse of authority; or a substantial and specific danger to the public health and safety. Individuals may disclose information or make complaints to the Inspector General through the OIG Hotline (see announcement on back cover page). The Inspector General protects the legal rights of whistle-blowers and complainants and takes great care not to disclose their identity without their consent.

OIG Hotline

The OIG operates a separate toll-free Hotline telephone number, a confidential fax, and a confidential Hotline post office box (see back page). The OIG Hotline telephone is answered by an investigative technician from 10:00 am to 3:00 pm, Monday through Friday. At other times, callers may leave a voice message and we will respond within one business day.

Significant Investigations

Ethical Misconduct

Manager Operates Travel Business at PBGC

We found a PBGC manager was using PBGC government resources while on official time to operate a travel agency service. On multiple occasions from 2001 through 2006, the manager used PBGC e-mail, telephone, and the fax to solicit, arrange and book travel for PBGC federal employees and private individuals and entities while at work. Federal ethics rules require employees to conserve Government property and not use such property, or allow its use, for other than authorized purposes. Additionally, PBGC's electronic communications policy specifically forbids using government resources to conduct a private business. The manager had received ethics training and was aware of PBGC's electronic communications policy. We issued an investigative report to management after the case was declined for prosecution.

Manager used PBGC resources to solicit and arrange travel for federal employees and contractors

Manager Reprimanded for Ethics Violation

In a previous semiannual report, we reported that a PBGC manager had engaged in ethical misconduct, including soliciting and receiving a \$2000 loan from an employee who was under the manager's direct supervision, and failing to list significant financial interests with a supervisor that must be disclosed on annual Federal financial disclosure forms. Federal ethics rules prohibit supervisors borrowing or receiving gifts of more than \$25 from a subordinate and federal law requires senior officials to disclose significant financial interests. We issued a report of investigation to management after the case was declined for prosecution. PBGC management issued a Letter of Reprimand as a result of our investigation.

Pension Fraud

Conviction and Restitution Ordered for Missing Participants' Checks

PBGC employees referred several suspicious claims to OIG concerning the PBGC Missing Participant Program. As part of an ongoing investigation, we identified numerous instances of identity theft, money laundering, bank fraud, and forgery. To carry out this fraud, several individuals participated in a scheme to claim benefits of missing participants and cash checks intended for participants PBGC is trying to locate. In completing the investigation, we worked closely with the Office of Attorney General and a Federal financial crimes task force in Pittsburgh, PA. The case has resulted in referrals to federal and state prosecutors. In August, one individual pled guilty and was sentenced by the United States District Court to 1 year in prison, three years of Supervised Release, and ordered to pay restitution of \$77,055. Prosecutors are considering charges for other individuals implicated in the case.

Non-receipt of Benefit Checks

PBGC referred a participant's claim that he had not received two of his pension checks to OIG. In pursuing the investigation, we worked closely with local police, bank fraud investigators, one of PBGC's regional Field Benefit Administration offices, and State Street Bank. Our investigation determined that the missing checks were fraudulently cashed by the participant's estranged wife. The case was declined for prosecution when the wife's bank froze sufficient assets to cover the amount of the missing pension checks and agreed to transfer the funds back to PBGC's trust fund.

***Pension Fraud results:
- man convicted for part
in identify theft ring
- estranged wife caught
stealing pension checks***

Management Advisory

During this reporting period, we issued a management advisory identifying several weaknesses within the Missing Participant program causing vulnerability to fraudulent activity. For example, we noted:

- Many people had access and ability to change personal information about pension participants, with no audit trail.
- Questions to verify the identity of purported participants who call to change personal information, such as address or bank information, were not effective.
- Authorizers had no process to verify the accuracy of changed information.

We met with PBGC management to discuss options and recommend actions to reduce the vulnerability of PBGC Missing Participant Program assets to future fraudulent schemes. The management advisory was the result of an on-going investigation in which the Corporation paid out more than \$162,000 based on fraudulent birth certificate documentation.

We also closed 7 inquires that raised issues of fraud relating to pension plans and benefits.

*Investigator's notify
management of
program vulnerabilities*

SUMMARY OF INVESTIGATIVE ACTIVITIES

For The Six-month Period Ending September 30, 2006

Investigations

Pending beginning of period	23
Opened	4
Closed	10
Pending end of period	17

Inquiries

Pending beginning of period	10
Opened	11
Closed	16
Pending end of period	5

Financial Recoveries*

Theft of Funds Recovered	\$4,732
Court Ordered Fines, Penalties, and Restitution	\$77,055
U.S. Government Property Recovered	0

Criminal Actions*

Arrests	0
Indictments	1
Convictions	1

Administrative Actions*

Terminations	1
Suspensions	1
Oral or Written Reprimand	1

Referrals

For Prosecution:	
Department of Justice	8
Declined	7
Various States' Attorney Offices	0
Declined	0
For Other Action:	
PBGC Management for Corrective Action	2

* Results reported for Financial Recoveries, Criminal and Administrative Actions include both open and closed cases.

Other Office of Inspector General Activities

Review of Proposed Statutory and Regulatory Changes

Statutes

A major responsibility of the OIG under the IG Act is to independently review changes to laws and regulations that are proposed by PBGC. In August 2006, the President signed into law the Pension Protection Act of 2006. This Act amended ERISA to provide simplicity, flexibility, accuracy and stability in the defined benefit pension insurance program that PBGC administers. Key hallmarks of the legislation were provisions to increase pension plans' funding of future promised benefits and the amount of premiums paid to PBGC, thereby decreasing PBGC's risk, and to require greater transparency in how well a pension plan is funded. As stated previously in this report, we are monitoring the impact of this significant amendment of ERISA Title IV.

Regulations

PBGC continues in a major effort to streamline its regulations and to improve administration of the pension insurance program, with a focus on making pension-related information more accurate, complete and transparent. PBGC issued a final rule on mortality assumptions used for valuing annuity benefits of missing participants, and policy guidance for premium penalty waivers. We reviewed and commented on these rules in prior reporting periods.

Internal PBGC Activities

OIG staff members have engaged in several activities within PBGC to promote fraud prevention, improve relationships between the OIG and PBGC, and provide consultations to managers to improve agency operations. Among these activities are the following:

- As part of our on-going effort with executive management to strengthen PBGC's ethical environment, the IG and General Counsel provided ethics training to supervisors and staff that emphasizes ethical leadership and encourage thinking beyond the requirements of ethics regulations.
- The Assistant IG for Investigations is participating as a non-voting member of the agency's Internal Control Committee, providing insight on fraud prevention and detection. This committee is responsible for oversight and accountability regarding PBGC internal controls over financial reporting and its operations

The Pension Protection Act of 2006: to provide for better funding of pension plans and greater stability for PBGC.

consistent with the Standards for Internal Control for the Federal Government (GAO Green Book), OMB Circular A-123, and Federal Managers' Financial Integrity Act requirements.

- The IG is again serving as an executive mentor in the "Leaders Growing Leaders" program.
- The investigators conducted fraud briefings at each training session for the agency's new travel system.

External Activities

Various staff members participated in external professional activities, including the following:

- The IG was an active participant of the Executive Council on Integrity and Efficiency (ECIE), a council of Inspectors General that promotes collaboration on integrity, economy, and efficiency issues that transcend individual agencies. During this reporting period, he continued to participate in initiatives to improve staff development in the IG community:
 - He served as Chairman of the Board of Governors for the newly-formed Inspector General Institute that was to combine schools of audit, investigations and management to provide training to over 11,000 professionals in the IG community by October 1, 2006. In the latter part of September, the IG community decided not to fund the Institute.
- The IG serves on the International Conference Committee of the Institute of Internal Auditors. The Committee focuses on identifying trends in internal auditing and organizing and hosting international professional development conferences.
- The Assistant IG for Audit is a member of the Federal Audit Executive Council (FAEC). The FAEC's purpose is to discuss and coordinate issues affecting the federal audit community, with special emphasis on audit policy and operations of common interest to FAEC members. He serves on the FAEC's Audit Committee that sponsored training in April on the new peer review guidance.
- IT Audit Manager serves as the Program Committee Chair for a chapter of the Information Systems Audit and Control Association (ISACA). This committee is responsible for setting the program for the membership's monthly meetings including topics and speakers to further the knowledge and skill level of its membership. All programs provide members an opportunity to receive continuing

OIG staff are encouraged to participate in external activities

professional education credits to meet their certification requirements in the fields of audit, technology, security, controls, and management for both the private and public sectors.

- The OIG was asked to provide staff to participate as external observers in Forward Challenge 06, the Government-wide initiative to test continuity of operations plans (COOP). The IT audit manager and an auditor observed the recovery process and execution of the Peace Corps' COOP. The Federal Emergency Management Agency (FEMA) was responsible for training personnel in their roles as observers and coordinating this exercise. The OIG staff observed the Peace Corps during the two-day exercise, then analyzed and reported the results to FEMA for compilation into a consolidated report to Congress.
- An OIG auditor serves as president of PBGC's local chapter of the Federal Manager's Association, which meets monthly for lunch to hear speakers on various management topics, discuss PBGC issues and network.
- Two OIG staff are tutoring children in PBGC's partnership with the Thomson Elementary School.

Internal OIG Initiatives

Hotline Expanded

We improved our OIG Hotline telephone by expanding the hours of operation. An investigative staff assistant will answer the Hotline (1-800-303-9737) from 10:00 am to 3:00 pm (Eastern Standard Time), Monday through Friday. Callers also may leave a voice message 24 hours a day, 7 days a week. We will review and respond to the caller within one business day. In addition to the hotline number, the OIG has a confidential Hotline post office box, and confidential hotline fax. We are setting up a confidential Hotline e-mail address and a marketing program to publicize the various ways individuals can confidentially contact the OIG.

Procurement Manual

The OIG exercises the contracting authority granted by the IG Act by conducting its own contracting and procurement program. We developed a Procurement Manual to document our processes for procuring goods and contract services within the OIG to establish responsibilities and ensure consistency.

OIG staff were external evaluators for the government-wide continuity of operations test

We expanded our Hotline telephone to provide better access

Appendix

CROSS-REFERENCE TO REPORTING REQUIREMENTS OF THE INSPECTOR GENERAL ACT

The table below cross-references the reporting requirements prescribed by the Inspector General Act of 1978, as amended, to the specific pages in the report where they are addressed.

Inspector General Act Reference	Reporting Requirements	Page
Section 4(a)(2)	Review of legislation and regulations.	23
Section 5(a)(1)	Significant problems, abuses, and deficiencies.	5-17, 19-21
Section 5(a)(2)	Recommendations with respect to significant problems, abuses, and deficiencies.	5-17, 19-21
Section 5(a)(3)	Prior significant recommendations on which corrective action has not been completed.	29
Section 5(a)(4)	Matters referred to prosecutorial authorities.	19-22
Section 5(a)(5)	Summary of instances in which information was refused.	17
Section 5(a)(6)	List of audit reports by subject matter, showing dollar value of questioned costs and recommendations that funds be put to better use.	28
Section 5(a)(7)	Summary of each particularly significant report.	5-17, 19-21
Section 5(a)(8)	Statistical table showing number of reports and dollar value of questioned costs.	28
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use.	28
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by end of reporting period.	17
Section 5(a)(11)	Significant revised management decisions.	17
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees.	17

REPORTS ISSUED WITH QUESTIONED COSTS AND FUNDS PUT TO BETTER USE*

For the Six-Month Period Ending September 30, 2006

	Number of Reports	Questioned Costs	Unsupported Costs**	Funds put to Better Use
A. For which no management decision had been made by the commencement of the reporting period.	13	\$5,783,148	\$4,843,822	-0-
B. Which were issued during the reporting period	3	\$450,096	-0-	-0-
Subtotal (Add A. & B.)	16	\$6,233,244	\$4,843,822	-0-
C. For which a management decision was made during the reporting period.	2	\$662,819	\$624,342	-0-
(i) dollar value of disallowed costs	-0-	-0-	-0-	-0-
(ii) dollar value of costs not disallowed	2	\$662,819	\$624,342	-0-
D. For which no management decision had been made by the end of the reporting period.	14	\$5,570,425	\$4,219,480	-0-
E. For which no management decision was made within six months of issuance.	11	\$5,120,329	\$4,219,480	-0-

*This statistical information is required by Section 5(a)(6)(8) and (9) of the Inspector General Act of 1978, as amended.

**Unsupported costs are a subset of questioned costs.

SIGNIFICANT PROBLEMS, DEFICIENCIES AND RECOMMENDATIONS

Report Number, Report Title and Date Issued	Number of Significant Recommendations	Significant Problems and Deficiencies	Summary of Significant Recommendations
96-4/23093-2 Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 1995 Financial Statements 03/13/1996	1**	Reportable Condition: Integrating Financial Management Systems	PBGC needs to complete the integration of its financial management systems.
2003-3/23168-2 Audit of the Pension Benefit Guaranty Corporation's Fiscal Years 2002 - 2001 Financial Statements 01/30/2003	2**	Reportable Condition: Implementing & Enforcing Information Security Program	PBGC needs to complete its efforts to fully implement and enforce an effective information security program.
2004-2/23176-2 Audit of the Pension Benefit Guaranty Corporation's Fiscal Years 2004 - 2003 Financial Statements 1/15/2004	3**	Reportable Condition: Improving Single-Employer Premium Accounting System	PBGC needs to improve controls related to single-employer premiums.
2006-1/FA-0014-1 Audit of the Pension Benefit Guaranty Corporation's Fiscal Years 2005 - 2004 Financial Statements 11/15/2005	3**	Reportable Condition: Strengthening Preparedness for Unanticipated Incidences & Disruptions	PBGC needs to strengthen its preparedness for unanticipated incidences and disruptions.

* This chart complies with Section 5(a)(1)(2)(3) and (6) of the Inspector General Act of 1978, as Amended.

** Includes Significant Recommendations from previous semi-annual reports on which corrective action has not been completed.

Glossary

Questioned Cost

A cost the OIG has questioned because of an alleged violation of law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds; because such cost is not supported by adequate documentation; or because the expenditure of funds for the intended purpose is unnecessary or unreasonable.

Unsupported Cost

A cost the OIG has questioned because of a lack of adequate documentation at the time of the audit.

Disallowed Cost

A questioned cost that management, in a management decision, has sustained or agreed should not be charged to the government.

Funds to Be Put to Better Use

Funds the OIG has identified in an audit recommendation that could be used more efficiently by reducing outlays, deobligating program or operational funds, avoiding unnecessary expenditures, or taking other efficiency measures.

Management Decision

Management's evaluation of audit findings and recommendations and issuance of a final decision concerning management's response to such findings and recommendations.

Final Action

The completion of all management actions described in a management decision with respect to audit findings and recommendations. If management concluded that no actions were necessary, final action occurs when a management decision is issued.

Misconduct

Action of employees or contractors that violates laws, rules, or regulations and for which corrective action is warranted.

If you want to report or discuss confidentially any instance of misconduct, fraud, waste, abuse, or mismanagement, please contact the Office of Inspector General.

Telephone:

The Inspector General's HOTLINE
1-800-303-9737

For deaf or hard of hearing people, dial FRS (800) 877-8339 and give the Hotline number to the agent.

Or write:

Pension Benefit Guaranty Corporation
Office of Inspector General
PO Box 34177
Washington, DC 20043-4177