



Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

**Fiscal Year 1998
Financial Statement Audit -
Management Report**

September 23, 1999

**Audit of PBGC's Fiscal Year 1998 Financial Statements
Management Letter
99-8/23132-3**

TABLE OF CONTENTS

Abbreviations	ii
Executive Summary	iii
Management Response and OIG Evaluation	iv
Introduction	1
Audit Objectives	1
Scope and Methodology	2
Audit Results	2
Findings and Recommendations	3
Current Year Findings and Recommendations	6
Status of Prior Year Findings and Recommendations	19

TAB

Management Response Memorandum	TAB I
--------------------------------	-------

**Audit of PBGC's Fiscal Year 1998 Financial Statements
Management Letter
99-8/23132-3**

ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
EIA	Earned Income Accrual
ERISA	Employee Retirement Income Security Act of 1974
FAM	Financial Audit Manual
FBA	Field Benefit Administrator
FMFIA	Federal Managers' Financial Integrity Act of 1982
FOD	Financial Operations Department
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	General Accounting Office
IDL	Initial Determination Letter
IOD	Insurance Operations Department
IPS	Image Processing System
IPVFB	Integrated Present Value of Future Benefits
IRMD	Information Resources Management Department
LAN	Local Area Network
OED	Office of the Executive Director
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAIB	Premium Audit and Investigation Branch
PAS	Premium Accounting System
PLUS	Pension and Lump Sum System
PBGC	Pension Benefit Guaranty Corporation
PCR	Premium Compliance Reviews
PDFN	Past Due Filing Notices
PRISM	Participant Records Information Systems Management
PVFB	Present Value of Future Benefits
SOA	Statements of Account
SSA	Social Security Administration
SSB	State Street Bank and Trust Company

**Audit of PBGC's Fiscal Year 1998 Financial Statements
Management Letter
99-8/23132-3**

EXECUTIVE SUMMARY

PricewaterhouseCoopers LLP (PricewaterhouseCoopers) was engaged by the Office of Inspector General (OIG) of the Pension Benefit Guaranty Corporation (PBGC or the Corporation) to conduct an audit of the financial statements of the Single-Employer and Multiemployer Program Funds administered by PBGC, as of and for the years ended September 30, 1998 and 1997. As presented in OIG Audit Report 99-7/23132-2, PricewaterhouseCoopers issued an unqualified opinion on the statements of financial condition and the related statements of operations and changes in net position and statements of cash flows. The report on PBGC's compliance with laws and regulations stated that the results of our tests disclosed no instances of non-compliance that are required to be reported under *Government Auditing Standards*, or the methodology set forth by the United States General Accounting Office's (GAO) *Financial Audit Manual* (FAM).

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants (AICPA). None of the reportable conditions was believed by us to be material weaknesses as defined by the AICPA. The reportable conditions we noted were: PBGC needs to integrate its financial management systems and improve its systems development life cycle methodology; PBGC needs to finalize and test its plan for maintaining continuity of operations; and PBGC needs to implement and improve controls surrounding the Participant Records Information Systems Management (PRISM) application. The detailed findings and recommendations related to the PRISM reportable condition are presented in Section 3 of this report.

This management report discusses findings and recommendations for improvements in the Corporation's internal control that were identified during our audit of the fiscal year 1998 financial statements. It contains 17 findings, which resulted in 24 recommendations that, although not considered material weaknesses, are serious enough to bring to management's attention. PBGC should implement the recommendations to strengthen its internal control. A majority of the findings are reported in three categories: lack of adequate controls over financial reporting, lack of compliance with PBGC's policies and procedures, and lack of adequate controls surrounding the PRISM application. In addition, in the section entitled "Prior-Year Findings and Recommendations," we have summarized the status of prior year audit recommendations included in OIG Audit Report Numbers 97-4/23110-2 and 97-23/23110-3, as of September 30, 1998. Recommendations that were deemed "completed" in prior years have not been carried forward.

MANAGEMENT RESPONSE AND OIG EVALUATION

PBGC management was provided a draft copy of this report for review and comment. We met with PBGC officials several times to discuss the impact of the report's findings and recommendations and provide greater detail from our fieldwork. After these discussions, the OIG removed from the draft report one finding related to eliminated or corrected premium Statements of Account. The OIG has incorporated several editorial changes suggested by PBGC management.

PBGC management commented on the Report and concurred "with its recommendations except for one item." Their comments are at Tab I. PBGC disagreed with the second recommendation of Finding 2.1 which states that PBGC should "modify existing Insurance Operations Department (IOD) procedures to require retention of source documentation generated as a result of the participant data audits and used to calculate benefit payments and value the PVFB liability."

In their response, PBGC stated that current IOD procedures indeed "require that source documentation is to be maintained to support participant data audits, the calculation of benefit payments, and the valuation of the Present Value of Future Benefits (PVFB) liability." However, the IOD Manual Section 12.5, "Perform Source Documentation Audit," clearly instructs IOD personnel to retain source documentation obtained from prior sponsors of terminated plans only for a sample of participants. This documentation consists of several sample files for each category of participants and is used to analyze the data gathered in the field. IOD's collection and retention of only a sample of participant data may not be adequate in the future to provide a proper audit trail to support benefit calculations and the PVFB liability. Proper audit trails have been historically material to PBGC's financial statements as a whole. In addition, throughout the IOD Manual a completeness of the participants' files is emphasized and encouraged. Complete documentation is the cornerstone for providing a proper audit trail to support data elements used to calculate benefits, and in turn, the PVFB liability. Failure to capture full and complete participant data could ultimately affect the overall financial statement opinions, including internal controls, in the future.

In addition, PBGC stated that this recommendation is "pending further discussions between OIG and IOD." While we are available to discuss the changes we believe are needed to IOD's Manual, whether the Manual must be modified is not in question. Even though PBGC has disagreed with a report recommendation, some modification to IOD's Manual will be necessary to resolve noted inconsistencies in IOD's Manual and to repair a damaged audit trail that currently is capturing incomplete participant data.

Audit of PBGC's Fiscal Year 1998 Financial Statements
Management Letter
99-8/23132-3

Introduction

As a government corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), the Pension Benefit Guaranty Corporation (PBGC or the Corporation) protects the pensions of more than 42 million Americans in approximately 44,000 private defined benefit pension plans, including about 2,000 multiemployer plans. PBGC's mission is to operate as a service-oriented, professionally managed agency that protects participants' benefits and supports a healthy retirement plan system by: (1) encouraging the continuation and maintenance of private pension plans; (2) protecting pension benefits in ongoing plans; (3) providing timely payments of benefits in the case of terminated pension plans; and (4) making the maximum use of resources and maintaining premiums and operating costs at the lowest levels consistent with statutory responsibilities. PBGC finances its operations through premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA, as amended, and investment income. In addition, PBGC may borrow up to \$100 million from the United States Department of the Treasury to finance its operations. To date, this borrowing authority has not been exercised.

Audit Objectives

The objectives of our audit were to determine whether:

- The financial statements present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 1998, and September 30, 1997, and the results of their operations and cash flows for the years then ended, in conformity with generally accepted accounting principles (GAAP).
- Management's assertion that PBGC's controls in effect as of September 30, 1998, provided reasonable assurance that assets were safeguarded from material loss and transactions were executed in accordance with management's authority and with significant provisions of selected laws and regulations, and furthermore, that PBGC controls provide reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds is fairly stated, in all material respects, based upon criteria contained in the Federal Managers' Financial Integrity Act of 1982 (FMFIA). This assertion is included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of PBGC's Fiscal Year (FY) 1998 Annual Report to the Congress.
- PBGC is in compliance with significant provisions of applicable laws and regulations.

Scope and Methodology

PricewaterhouseCoopers LLP (PricewaterhouseCoopers) was engaged by the Office of Inspector General (OIG) of PBGC to conduct an audit of the financial statements of the Single-Employer and Multiemployer Program Funds administered by PBGC as of and for the years ended September 30, 1998, and September 30, 1997.

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

An audit of financial statements conducted in accordance with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and the methodology set forth by GAO's FAM is not designed to detect whether PBGC's systems are Year 2000 ready. Furthermore, we have no responsibility with regard to PBGC's efforts to make its systems, or any other systems, such as those of PBGC's vendors, service providers, or any other third parties, Year 2000 ready and no responsibility to provide assurance on whether PBGC has addressed or will be able to address all of the affected systems on a timely basis. These are the responsibilities of PBGC's management.

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

Audit Results

As a result of our FY 1998 audit, we issued the following reports:

- (a) an unqualified opinion on PBGC's statements of financial condition, and the related statements of operations and changes in net position and statements of cash flows, as of and for the years ended September 30, 1998, and September 30, 1997 (OIG report number 99-7/23132-2);
- (b) a report on PBGC's compliance with laws and regulations that noted no instances of non-compliance with the provisions tested; and
- (c) a report on internal control that identified three reportable conditions, one of which is recurring. These reportable conditions were not deemed to be material weaknesses as defined by standards established by AICPA.

Our FY 1998 report on internal control disclosed the reportable condition related to the lack of integration of the Corporation's financial management systems, including the need for an adequate systems development life cycle methodology and the need for adequate systems development monitoring and oversight. This reportable condition was also reported in FYs 1997 and 1996. During FY 1998, PBGC made some progress in addressing the issue. However, additional work is required to ensure that PBGC's financial management systems are integrated, the formal systems development life cycle methodology is implemented, and specific criteria allowing the Corporation to effectively monitor systems outsourcing are identified and followed.

Two new reportable conditions identified in our FY 1998 report on internal control were: PBGC needs to finalize and test its plan for maintaining continuity of operations and PBGC needs to implement and improve controls surrounding the Participant Records Information Systems Management (PRISM) application.

In addition to the reportable conditions specified above, during our FY 1998 audit, we identified a number of internal control weaknesses that, although not considered material weaknesses or reportable conditions, we believe warrant the attention of management. This management report summarizes our findings and recommendations for improvement in the Corporation's internal control.

Findings and Recommendations

This report contains 17 findings from our FY 1998 testing which resulted in 24 recommendations that PBGC should implement to strengthen the Corporation's internal control. Additionally, in the section entitled "Prior-Year Findings and Recommendations," we have summarized the status of prior-year audit recommendations included in OIG Audit Report Numbers 97-4/23110-2 and 97-23/23110-3, as of September 30, 1998.

The remainder of this report is comprised of the following:

- A table listing our current year recommendations (Pages 4-5) .
- A discussion of each current year finding and corresponding recommendation(s) (Pages 6-19).
- A table listing each of the outstanding prior year findings and their status as of September 30, 1998 (Pages 19-21).

Summary of Current Year Recommendations	
Recommendation	Page Number
1. Enhance financial reporting controls surrounding PAS to improve the system's ability to accurately track premiums receivable on a plan basis. (FOD-274)	7
2. Analyze the existing year-end processes surrounding PAS and identify improvements that will reduce the necessity of manual adjustments, validity testing, and reclassifications at year-end. (FOD-275)	7
3. Enforce existing IOD policies and procedures requiring that participants' files contain complete information critical for the benefit payments and the PVFB liability calculation. (IOD-169)	8
4. Modify existing IOD procedures to require retention of source documentation generated as a result of the participant data audits and used to calculate benefit payments and value the PVFB liability. (Disagreed-1)	8
5. Develop, implement, and enforce consistent procedures for reinstating participants into pay status. (IOD-170)	9
6. Enforce policies and procedures related to the maintenance of plan file documentation at the FBAs and headquarters. (IOD-171)	9
7. Require all premium compliance reviews to be performed, documented, and approved in accordance with PBGC's Premium Compliance Review Procedures Manual. (FOD-276)	10
8. Develop and implement formal procedures for closing premium compliance reviews in progress prior to completion. (FOD-277)	10
9. Develop and implement accounting procedures for recording the results of PCR into PAS at the point the debt is determined. (FOD-227)	11
10. PBGC needs to enhance the change control process used in maintaining and supporting its application systems and include it as part of the overall System Development Life Cycle currently being developed. (IRMD-108)	12
11. PBGC needs to develop and formalize criteria for assessing business and information technology risks that can be used internally and for contractors performing independent reviews. (IRMD-109)	12
12. Enforce policies and procedures that require participants' records in PRISM contain information that is adequately supported in IPS. (IOD-172)	13
13. Enforce existing policies and procedures related to the information that should be captured by FBAs in the participants' records in PRISM. (IOD-173)	14
14. Maintain an adequate audit trail of decisions affecting the integrity of participants' data. (IOD-174)	14
15. Delete invalid duplicate participant records in PRISM and implement necessary controls to prevent the creation of duplicate records in future processing. (IOD-175)	14

Summary of Current Year Recommendations	
Recommendation	Page Number
16. <i>Apply transactions to participants' records in PRISM properly and timely. (IOD-176)</i>	15
17. <i>Properly authorize special check payments in accordance with authorization thresholds established by PBGC. (IOD-177)</i>	15
18. <i>Develop and implement formal reconciliation procedures that require the reconciling items between PRISM and PLUS records be resolved timely and their resolution be sufficiently documented. (IOD-178)</i>	16
19. <i>Require formal managerial review and approval of reconciliations between PLUS and PRISM. (IOD-179)</i>	16
20. <i>Implement the deathmatch controls. (IOD-180)</i>	16
21. <i>Establish a formal reconciliation process for the plans assumed from the prior paying agents whereby reconciliations are reviewed and approved by an appropriate level of management. (IOD-181)</i>	17
22. <i>PBGC should include in its development of a formal systems development life cycle methodology policies and procedures that address adequate controls for the segregation of functions performed in the development and production environments. (IRMD-110)</i>	18
23. <i>PBGC should include in its development of a formal systems development life cycle methodology policies and procedures that implement and enforce adequate monitoring controls for significant activities performed by individuals and/or systems. (IRMD-111)</i>	18
24. <i>PBGC should implement policies and procedures that would control the assignment of excessive responsibilities, including the development of adequate monitoring of activities performed by individuals and/or systems. (IOD-182)</i>	19

Current Year Findings and Recommendations

1. CONTROLS OVER FINANCIAL REPORTING REQUIRED STRENGTHENING.

Financial statement reliability is dependent on maintaining adequate and functioning accounting controls. An internal control is a set of policies and procedures established and maintained by management in order to meet its internal control objectives. The objectives of internal control generally include but are not limited to (a) adherence to management's policies and procedures, (b) the safeguarding of assets, and (c) the accuracy and completeness of the accounting records. Adequate internal control can reduce the risk that financial statements contain material misstatements. During our FY 1998 testing, we identified several control weakness issues related to financial reporting that require PBGC management's attention.

1.1 Premium receivable balance was generated by the Premium Accounting System (PAS) using incorrect data.

PBGC uses information contained on Statements of Account (SOAs), Past Due Filing Notices (PDFNs) and Earned Income Accrual (EIA) balances to generate its year-end premiums receivable balance. During our FY 1998 testing, we found instances when SOAs and EIAs balances were misstated due to incorrect plan data.

When a plan underpays or submits an incomplete or a late filing form, PAS generates a SOA. This statement has a direct financial statement impact, as it represents a premium receivable. Additionally, EIA, an accrual for income earned but not yet due, makes up a portion of the Corporation's receivable balance. Our FY 1998 testing identified instances when PAS generated SOAs for plans that did not owe money to PBGC. Furthermore, we identified instances when PBGC accrued earned income using incorrect plan data maintained on PAS. Accordingly, the individual plan receivable balances generated as a result were inaccurate.

If a plan does not submit a timely premium filing form, PAS generates a PDFN that should be mailed to the plan sponsor as a reminder that the payment is due. A PDFN also allows PAS to track all plans that have not filed on time and represents an important control over completeness of premiums receivable. During our FY 1998 testing, we noted that PDFNs were generated on a test basis for plans that did not file in FY 1997 and were not mailed to late filers. As a result, PBGC used another method to ensure the completeness of premiums receivable. If the Corporation cannot accurately and completely account for receivables on a plan basis, the amounts reported in the financial statements may be potentially misstated.

Recommendation

We recommend the following corrective action:

Enhance financial reporting controls surrounding PAS to improve the system's ability to accurately track premiums receivable on a plan basis. (FOD-274)

1.2 PBGC performed numerous manual reclassifications and adjustments to the year-end premium balances generated by PAS.

PAS premium related accounts reflect all activity dating back to the inception of PAS in 1994. PAS accounts are not reset at fiscal year-end. To arrive at final balances, PBGC is required to perform numerous manual adjustments, validity testing, and reclassifications between single employer and multiemployer funds. This current methodology is a complex and inefficient process that will continue to become more burdensome with the passage of time. Such processes increase the possibility that misstatements could arise at both the subsidiary system and financial statement level and not be detected.

Recommendation

We recommend the following corrective action:

Analyze the existing year-end processes surrounding PAS and identify improvements that will reduce the necessity of manual adjustments, validity testing, and reclassifications at year-end. (FOD-275)

2. COMPLIANCE WITH PBGC'S POLICIES AND PROCEDURES NEEDED STRENGTHENING.

An entity develops and implements policies and procedures to help provide order, ensure consistency in processing among personnel, and provide guidance to new or reassigned personnel. Management also develops policies to help ensure compliance with applicable laws and regulations, to guide personnel in the implementation of internal controls, and to help prevent fraud, waste, or abuse from occurring and not being detected timely. If policies and procedures are not followed, inconsistent or ineffective processing of accounting transactions may occur, resulting in possible errors or irregularities. We identified the following instances of non-compliance with PBGC's policies and procedures:

2.1 Core documentation was not maintained in the participants' files in the Image Processing System (IPS).

During our FY 1998 audit, we identified instances where participants' files in IPS did not contain core documentation as required by the Insurance Operations Department (IOD) Manual. The core documentation for participants in pay status and deferred vested participants includes the Trusteeship Notification Letter, General Information Sheet, Proof of Age, and Proof of Marital Status. We identified that several files of the participants in pay status were missing core documentation and the Initial Determination Letters (IDL). Our testing also revealed that even fewer documents were maintained in the deferred vested participants' files. In addition to the lack of core documentation, we noted instances of non-compliance with policies and procedures related to issuance of the trusteeship notification letter (i.e., 4042 letter). We also noted that several files for deferred vested participants were missing in IPS.

The IOD Manual does not require retention of all source documentation obtained at the participant data audits. As of FY 1996, auditors responsible for participant data audits were instructed not to retain source documents that were obtained from prior sponsors of terminated plans. These documents were used to build the participant database and calculate benefit payments. According to the IOD Manual, only source documents for a sample of participants in each plan are retained. This practice results in conflicts between the IOD Manual provisions that require completeness of the participants' files and, at the same time, does not require maintaining source documentation already obtained from the prior plan sponsors. It may also create inefficiencies in the data gathering process when the same participant information might be requested for the second time.

Absence of the appropriate source documentation in the participants' files and delays in creating participants' files in IPS could jeopardize the integrity of the calculation of the benefit payments and Present Value of Future Benefits (PVFB) liability amounts. It also causes a disruption of a clear audit trail, making it difficult to undertake an independent confirmation of the validity of participant data.

Recommendation

We recommend the following corrective actions:

Enforce existing IOD policies and procedures requiring that participants' files contain complete information critical for the benefit payments and the PVFB liability calculation. (IOD-169)

Modify existing IOD procedures to require retention of source documentation generated as a result of the participant data audits and used to calculate benefit payments and value the PVFB liability. (Disagreed-1)

2.2 Inconsistencies existed among the FBAs in reinstating participants into pay status.

Our FY 1998 testing of internal control at FBAs indicated that inconsistencies existed in reinstating participants taken out of pay status due to death notifications. One FBA required that participants submit a notarized statement to verify that participants were alive while another FBA reinstated participants after a telephone verification. This condition occurred due to the lack of specific policies and procedures related to verifying participants' information prior to reinstating them into pay status. Lack of such procedures may lead to the situation when not enough evidence is obtained to mitigate the risk of fraud that benefit payments are paid to unauthorized individuals.

Recommendation

We recommend the following corrective action:

Develop, implement, and enforce consistent procedures for reinstating participants into pay status. (IOD-170)

2.3 Compliance with policies and procedures related to the plan documentation maintenance should be strengthened at PBGC.

IOD's policies and procedures set forth certain maintenance requirements for preserving plan documents and other related information at FBAs and the headquarters. Our FY 1998 testing identified across-the-board non-compliance with many of these policies and procedures. Though we found that plan files of the recently terminated plans were better maintained, improvements in enforcing these policies and procedures are still critical. Without enforcement and compliance, there is a risk that PBGC would not be able to substantiate certain valuations or decisions related to plan termination and administration.

Recommendation

We recommend the following corrective action:

Enforce policies and procedures related to the maintenance of plan file documentation at the FBAs and headquarters. (IOD-171)

2.4 Premium Compliance Review (PCR) procedures were not followed consistently.

Independent review and approval are an integral part of any effective internal control. Our FY 1998 testing identified several instances where PBGC failed to approve or complete certain procedures related to PCR, mainly performed by PBGC's contractors. Specifically, PBGC's Premium Audit and Investigation Branch (PAIB), which is in charge of performing PCRs, failed to:

- approve several completed reviews;
- complete the required portions of the audit program, including PCR Checklist;
- approve deviations from the standard audit program;
- formally document reasons for review termination prior to completion;
- identify an improper waiver by a contractor of amounts due to PBGC; and
- identify inconsistent applications of documentation policies on behalf of contractors.

Lack of proper review or approval of PCR results increases the possibility that errors may go undetected and lead to misstatements in the financial statements.

Recommendation

We recommend the following corrective actions:

Require all premium compliance reviews to be performed, documented, and approved in accordance with PBGC's Premium Compliance Review Procedures Manual. (FOD-276)

Develop and implement formal procedures for closing premium compliance reviews in progress prior to completion. (FOD-277)

2.5 Amounts due to PBGC were not posted to PAS timely.

PCR work may result in an accrual of premiums receivable, followed by settlements and collections. Our FY 1997 testing identified the lack of a documentation link between PCR findings and PAS. In FY 1998 testing, we found that a link was created; however, the dollar amounts identified as due to PBGC were not posted to PAS timely. If the receivable amounts are not posted to PAS timely, there is a risk that the collection of these amounts is not properly tracked thus reducing the effectiveness of PCR and causing misstatements in PBGC's financial statements. This condition and the resulting recommendation have been previously identified by the OIG's report, *Inspection of PBGC's Premium Compliance Program (97-6/23102-3)*, issued August 7, 1997.

Recommendation

As identified in the OIG report, the following corrective action is recommended:

Develop and implement accounting procedures for recording the results of PCR into PAS at the point the debt is determined. (FOD-227)

2.6 PBGC's information technology control policies and procedures have not been updated to reflect the recent migration to a client-server environment.

The policies and procedures contained in the draft Information Resources Management Department (IRMD) Change Management document that formalizes the process used by PBGC to report, record, and approve changes to systems and application software need to be expanded to include the change management process related to the client-server environment. In conjunction with the Systems Development Life Cycle methodology, change management within the development and maintenance environment is a significant control. As PBGC's information technology environment has undergone transition from the mainframe to the client-server environment, the Change Management policies have not been modified to reflect this migration. As defined in the Office of Management and Budget (OMB) Circular A-127, management is responsible for defining a system development methodology, including a controlled approach to maintain and support these systems during implementation and operational status. The enhancements to the change control process should include:

- change management process for modifications to security and database settings in the client-server environment;
- security requirements during the change control process;
- impact analysis including assessment of changes and identification of affected data elements; procedure to be followed to control the transfer of configuration elements between development, test, and production environments; and
- source code version control.

PBGC contracts with third-party vendors or contractors for ongoing assessments of its business applications for certification and accreditation purposes, thereby assisting management with compliance to the FMFIA requirements. However, PBGC has not established the criteria for assessing business and information technology risks to be used by these contractors as benchmarks for their work. Such criteria should include:

- identification of sensitive or critical resources in conjunction with information owners, business, and technical staff;
- quantification of risks and standardization of risk categories;
- selection of cost-effective information controls;

- performance of risk assessments; and
- risk acknowledgment where management determines it is impractical, inefficient, or not cost-effective to implement a recommended control.

Recommendation

We recommend the following corrective actions:

PBGC needs to enhance the change control process used in maintaining and supporting its application systems and include it as part of the overall System Development Life Cycle currently being developed. (IRMD-108)

PBGC needs to develop and formalize criteria for assessing business and information technology risks that can be used internally and for contractors performing independent reviews. (IRMD-109)

3. CONTROLS OVER THE PRISM APPLICATION WERE NOT ADEQUATE.

PBGC's long-term ability to provide timely benefit payments to participants of terminated pension plans and to prepare reliable financial statements is significantly dependent on its effectiveness in managing accurate and complete participant records. Prior to FY 1998, PBGC's custodian bank, SSB, maintained and managed participant data for PBGC. During FY 1998, PBGC implemented PRISM, a new in-house database and information management system, and assumed control over participant information. Participant records were converted from the pay-based SSB database, Pension and Lump Sum System (PLUS), to the customer-based PRISM database (Genesis). While PBGC has designed and placed in operation many important monitoring and information technology controls over the PRISM database and applications, our FY 1998 audit identified areas where these controls could be strengthened to reduce risks associated with the benefit payment process and participant record integrity.

Below, Section 3 discusses findings and recommendations for improvements in controls surrounding the PRISM application that constituted the basis for the third reportable condition included in our FY 1998 Independent Accountants' Report on Internal Control (99-7/23132-2).

3.1 Data Integrity and Processing

Audit procedures performed on participant records maintained in PRISM (Genesis) identified the following participant data integrity and processing issues:

3.1.1 Participant records did not always agree to or were missing proper source documentation in IPS.

During our FY 1998 testing of the data generated from the PRISM database, we noted numerous instances where data maintained in PRISM did not agree to or was not supported by information in IPS. Specifically, the following instances were noted:

- IPS did not always contain documentation to support the participant's deceased status;
- The bank account numbers in PRISM were not always in agreement with or were not supported in IPS;
- The benefit cutback amounts in PRISM did not always match the benefit cutback amounts indicated by IDL in IPS;
- Key dates in PRISM (e.g., date of birth, date of hire) were not always in agreement with the supporting documentation in IPS;
- The lump sum payment to participants, who received monthly and lump sum payments, were not always supported in IPS;
- Some large lump sum payments were not supported in IPS to substantiate calculations and reasons for such payments; and
- Some participants' files were missing in IPS.

These instances occurred due to data entry errors, lack of follow-up with participants or their relatives, delays in issuing adjusted IDLs to participants, and failure to image supporting documentation. In order to value correctly its liabilities, PBGC needs to maintain adequate and accurate participant information. If the information in the PRISM database is not complete and accurate, there is a possibility that the PVFB liability and participant benefit calculations could be misstated.

Recommendation

We recommend the following corrective action:

Enforce policies and procedures that require participants' records in PRISM contain information that is adequately supported in IPS. (IOD-172)

3.1.2 Participant data were not always input into PRISM timely.

During our testing at one of the FBAs, we noted instances where beneficiary information for several participants who had made a joint and survivorship election was not input in PRISM timely thus jeopardizing the accuracy of data in the participants' records. In accordance with the policies and procedures, as specified in the IOD Manuals, accurate participants' data is an important element of PBGC's financial statements, as PRISM provides data used to value the PVFB. Beneficiary information was not input into PRISM timely due

to a miscommunication between the FBAs and the PRISM team at the headquarters. If beneficiary information is not entered timely into participants' records, the PVFB liability for these participants could be misstated.

Recommendation

We recommend the following corrective action:

Enforce existing policies and procedures related to the information that should be captured by FBAs in the participants' records in PRISM. (IOD-173)

Maintain an adequate audit trail of decisions affecting the integrity of participants' data. (IOD-174)

3.1.3 Erroneous duplicate participant records were found in PRISM.

During our testing of the PRISM database, we noted instances of erroneous duplicate participant records. Duplicate participant records were created in PRISM at the time of conversion from PLUS. PBGC invested significant efforts into resolving the problem; however, erroneous duplicate records still existed in PRISM at year-end. This situation caused a year-end adjustment to the PVFB liability. Additionally, we noted that some of the duplicate records had payment ledgers established under both records. It is important for PBGC to ensure that erroneous duplicate participant records are not maintained in PRISM. This control should eliminate the potential risk of invalid payments to participants and the related misstatement of the PVFB liability on PBGC's financial statements.

Recommendation

We recommend the following corrective action:

Delete invalid duplicate participant records in PRISM and implement necessary controls to prevent the creation of duplicate records in future processing. (IOD-175)

3.1.4 Data processing errors occurred in PRISM.

During our testing we noted instances when data processing errors caused substantial delays in input and duplicate input of financial information such as benefit payment credits. Specifically, we identified several instances when returned checks, recoupments of overpayments to deceased participants, and payments to participants issued via special checks were properly credited to the participants' records in PLUS at SSB but were not reflected in PRISM. We also noted instances when the same checks were credited twice in the participants' records in PRISM.

In addition, we identified instances when data processing errors in PRISM resulted in erroneous benefit payments to participants via special checks. We identified a special check transaction for an unusually large amount that was processed in error and paid in the December 1997 check run. At that time, the system allowed creation of multiple payment records via special checks for the same participant. When PBGC identified the processing problem, a unique payment ID was added to enhance the control over special check processing. However, to prevent reoccurrence, an improvement is needed in related controls such as reconciliation to minimize the risk of this error reoccurring.

Recommendation

We recommend the following corrective actions:

Apply transactions to participants' records in PRISM properly and timely. (IOD-176)

Properly authorize special check payments in accordance with authorization thresholds established by PBGC. (IOD-177)

3.2 Policies and Procedures

Although PBGC has begun updating the existing policies and procedures to address PRISM-related changes in information processing, we identified instances where important control procedures were not performed adequately or were not documented in sufficient detail.

3.2.1 Reconciliations between projected benefit payments and actual disbursements were not performed timely or sufficiently documented.

Reconciliations between projected benefit payments as reported by the PRISM Balancer module and actual disbursements made by SSB represent an important internal control over the benefit payment process. Balancer module is designed to compare the projected benefit payment amounts according to PRISM database with the actual payment ledgers generated by SSB and permits the system administrator to resolve discrepancies and document their resolution in the database. Balancer, which was not operational for several months after the system implementation in October 1997, started producing reports necessary to perform such reconciliations late in FY 1998. However, the reconciliations were not documented, the discrepancies between PRISM and SSB records were not resolved timely, and did not contain evidence of the supervisory review and approval. This condition was caused by lack of formal reconciliation procedures, including clearly defined accountability requirements.

Without a proper reconciliation between what PBGC has authorized for payment and what SSB disbursed to participants, controls are compromised. Erroneous payments issued by SSB may not be detected by PBGC and unauthorized transactions could be erroneously paid on behalf of PBGC. Additionally, if reconciling items are not resolved timely, errors may occur and remain undetected in both databases.

Recommendation

We recommend the following corrective action:

Develop and implement formal reconciliation procedures that require the reconciling items between PRISM and PLUS records be resolved timely and their resolution be sufficiently documented. (IOD-178)

Require formal managerial review and approval of reconciliations between PLUS and PRISM. (IOD-179)

3.2.2 Deathmatch control was not operational.

A significant data integrity control known as deathmatch was not operational in FY 1998. The control enables PBGC to identify deceased participants and update PRISM records. In the past, deathmatch was performed regularly by SSB. PBGC took over this function in FY 1998, but, as of September 30, 1998, this procedure was not performed. PRISM has a Deathmatch module that is designed to compare the PRISM database against the Social Security Administration (SSA) deceased participant records on a quarterly basis. In FY 1998, this match was performed on a test basis. However, no verification letters were sent to the participants on the match list. If the deathmatch is not performed properly with appropriate follow-up, PBGC will be facing a risk that benefit payments may be made to deceased participants.

Recommendation

We recommend the following corrective action:

Implement the deathmatch controls. (IOD-180)

3.2.3 Reconciliations of participants in assumed plans were not formally documented or were not performed.

In November 1997, PBGC assumed from SSB responsibility for converting plan records from the prior paying agents. In FY 1998, IOD conducted conversion of plan data manually because the PRISM Data Hub module was not operational. The Data Hub module is designed to load data for plans assumed by PBGC into PRISM (Genesis) database

electronically. During FY 1998, we identified that no formal reconciliation was performed between prior paying agent payment records and manual loads in PRISM. IOD performed informal verification to ensure that all participants in pay status have been loaded in PRISM. However, its results were not documented and there was no evidence of management's review and approval. No reconciliations of the deferred vested participants' data in assumed plans were performed.

At the time of transition such as transferring the function from one entity to another, a proper audit trail is essential to ensure that the processes can be reperformed and errors can be corrected timely. Without proper reconciliation and management's review and approval of such reconciliation, participant information could be missing or entered incorrectly.

Recommendation

We recommend the following corrective action:

Establish a formal reconciliation process for the plans assumed from the prior paying agents whereby reconciliations are reviewed and approved by an appropriate level of management. (IOD-181)

3.3 Segregation of Duties

Segregation of duties, as a control, establishes an environment in which no single individual is given the ability to initiate, create, modify, and delete data. If management establishes such an environment, adequate monitoring capabilities should be implemented to allow for an independent review of an individual's actions.

3.3.1 PBGC assigned the PRISM development team duties that did not adequately promote a controlled development environment.

During fiscal year 1998, the PRISM development team performed functions that would not be considered compliant with a properly controlled environment, as defined by business best practice and OMB A-130. In addition to the on-going development of the application modules, the team members were assigned the responsibility for the database conversion and implementation of the system into production, as well as error correction, maintenance, support, and database administration of both the development and production environments. Although PBGC is in the process of reassigning responsibilities for the maintenance and support of PRISM, this issue of controlling the two separate environments, development and production, was not addressed as of September 30, 1998.

During fiscal year 1998, there were no monitoring controls in place that would enable PBGC to detect potential unauthorized data modifications caused by an inadequate

segregation of duties. While PRISM contains an authorization log and an audit trail for each transaction, there were no formal reports produced for independent review, nor were there specific policies and procedures requiring supervisory review of such reports. Monitoring controls and an adequate segregation of duties between development and production functionality would strengthen the system development and change control process, thereby reducing the risk of unauthorized modifications to data or system resources.

Recommendation

We recommend the following corrective action:

PBGC should include in its development of a formal systems development life cycle methodology policies and procedures that address adequate controls for the segregation of functions performed in the development and production environments.
(IRMD-110)

PBGC should include in its development of a formal systems development life cycle methodology policies and procedures that implement and enforce adequate monitoring controls for significant activities performed by individuals and/or systems.
(IRMD-111)

3.3.2 PBGC assigned operational and security responsibilities to one individual without implementing adequate controls to monitor activity.

During fiscal year 1998, one individual was assigned excessive functionality for both PRISM application security and operational responsibilities. These responsibilities included:

- Granting access to individuals for entering and approving financial data;
- Re-routing financial transactions to alternate approval queues;
- Approving financial transactions not previously approved timely by authorized individuals; and
- Performing certain financial reconciliations.

Financial reconciliations performed by this individual included (a) reconciliations between projected benefit payments as reported by PRISM and actual disbursements made by SSB in PLUS and (b) reconciliations between benefit funding requests approved by PBGC and benefit payments disbursed by SSB.

During our testing, we noted that in FY 1998 there was a lack of monitoring controls in place that would enable PBGC to detect potential unauthorized data modifications due to this individual having the authority to initiate, create, modify, and delete data. For example, we found that both types of financial reconciliations did not contain evidence of

the supervisory review and approval. The lack of adequate controls to monitor the overlap of responsibility assigned to one individual increases the risk that unauthorized activity may occur and not be detected in a timely manner.

Recommendation

We recommend the following corrective action:

PBGC should implement policies and procedures that would control the assignment of excessive responsibilities, including the development of adequate monitoring of activities performed by individuals and/or systems. (IOD-182)

Status of Prior Year Findings and Recommendations

While we recognize that the Corporation has put forth considerable efforts to implement policies and procedures to mitigate or otherwise resolve the findings reported in our FY 1993 to FY 1996 audit reports (OIG Audit Report Numbers 94-1/23069-2, 94-7/23079-2, 95-7/23083-2, 96-9/23093-3, and 97-4/23110-2), as of September 30, 1998, a number of findings and related recommendations had yet to be completed and implemented.

The following schedule identifies the status of the 28 recommendations that were outstanding as of September 30, 1997. Follow-up of prior year findings and recommendations was performed, in part, to determine the nature, timing, and extent of the current year's audit procedures. The status was determined through review of management's responses to the OIG's semi-annual report of audit recommendations, additional audit testing performed, and discussions held with the appropriate management personnel. The status of these prior-year findings is as of September 30, 1998, and may not necessarily represent the status as of the date of the issuance of this report. The "status" category of each prior-year finding corresponds to the categories as used by the OIG in the Semiannual Report of Follow-up of Audit Recommendations, defined as follows:

- Completed -- The OIG concurs with PBGC management that the recommendation had been implemented. Therefore, this recommendation will no longer be tracked by the OIG and reported in future Semiannual Reports on Follow-up Audit Recommendations.
- Initiated, Not Completed -- Steps have been taken by PBGC management to implement the recommendation. However, further actions are still needed by PBGC to implement the recommendation. Therefore, this status of the recommendation will continue to be tracked by the OIG.
- Not Initiated -- No steps have been taken by PBGC management to implement the recommendation. Therefore, this status of the recommendation will continue to be tracked by the OIG.

OIG Control Number	Status of Prior Year Findings and Recommendations As of September 30, 1998	Status as of September 30, 1998
Fiscal Year 1996		
FOD-216 FOD-217 FOD-219	Controls surrounding PAS require improvement.	Completed Initiated, Not Completed Completed
FOD-259 FOD-261 IOD-141	PBGC did not always maintain a proper audit trail to support the component line items presented in the Corporation's financial statements or the underlying controls related to financial reporting.	Initiated, Not Completed Completed Initiated, Not Completed
FOD-263 FOD-264 FOD-265 FOD-266 IOD-142	PBGC personnel did not always comply with PBGC policies and procedures.	Initiated, Not Completed Initiated, Not Completed Completed Completed Completed
IOD-143	Participant data maintained on PLUS did not always agree to the supporting documentation maintained by PBGC.	Superseded by IOD-151
IOD-144	Develop procedures to implement PBGC's policy to conduct an expense assumption study on a predetermined schedule or when certain conditions (economic or political) exist to determine the reasonableness and validity of this assumption.	Initiated, Non Completed
OED-9	Develop and document a formal methodology for calculating the general unidentified single-employer probable contingency reserve based on an analysis of related industry trends and historical information.	Initiated, Non Completed
FOD-267	Develop and implement procedures to validate single-employer data reported on the Form 1.	Completed
Fiscal Year 1995		
FOD-193b	Develop and follow a formal systems development life cycle methodology on all subsequent system acquisition or development projects.	Superseded by IRMD-92

OIG Control Number	Status of Prior Year Findings and Recommendations As of September 30, 1998	Status as of September 30, 1998
FOD-195	Explanations for changes to the reasonably possible contingency inventory list of plans were not always documented or supported by a Contingency Classification Form A.	Completed
IOD-137	Reconciliations of the number of benefit checks processed by SSB and its contractor are not always performed or adequately supported.	Initiated, Not Completed
IRMD-75 IRMD-76	PBGC has not formally documented its policies and procedures related to computer program changes.	Initiated, Not Completed Initiated, Not Completed
IRMD-80 IRMD-81	Access to the mainframe security system is not adequately limited.	Completed Initiated, Not Completed
IRMD-83	Several generic user IDs were found in the system.	Completed
IRMD-84	The Corporation's disaster recovery plan does not include local area networks.	Initiated, Not Completed
Fiscal Year 1994		
IOD-127 IOD-129	General controls surrounding the Integrated Present Value of Future Benefits (IPVFB) Local Area Network (LAN) are inadequate.	Initiated, Not Completed Initiated, Not Completed
Fiscal Year 1992		
IOD-67	PBGC did not always maintain adequate documentation to support the participant data residing on PLUS.	Superseded by IOD-151
IOD-66	Controls related to the input on non-financial participant data to PLUS are inadequate to ensure the veracity of the data maintained therein.	Superseded by IOD-152



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

AUG 31 1999

To Wayne R. Poll
Inspector General

Thru Joseph Grant, Deputy Executive Director
and Chief Operating Officer

John Seal, Deputy Executive Director
and Chief Management Officer

From N. Anthony Calhoun, Deputy Executive Director
and Chief Financial Officer

Subject Comments on the Draft FY 1998 Financial Statements Audit - Management Letter
Report 99-8/23132-3 dated July 29, 1999

We appreciate the opportunity to comment on the subject draft report and we concur with its recommendations except for one item. Further discussions are needed between your office and the Insurance Operations Department on finding 2.1, core documentation, and the recommendation to modify existing IOD procedures. We will be pleased to meet with you and your staff on this issue.

The meetings you have conducted with the individual departments have helped to clarify issues raised during the exit conference, and we appreciate the revisions already made to the draft report as a result of these discussions. The comments attached reflect our understanding of the draft report as it relates to the Insurance Operations Department.

If you have questions or concerns regarding the attached comments, please let us know.

Attachment

cc David M. Strauss

Comments on the Draft FY 1998 Audit Management Letter

Recommendation 4: Enforce existing IOD policies and procedures requiring that participants' files contain complete information critical for the benefit payments and the PVFB liability calculation

IOD Comment: We agree. This recommendation will be incorporated into IOD Quality Assurance Initiative to be reviewed on a regular basis. We are reviewing documentation provided by the financial auditors supporting this audit recommendation.

Recommendation 5: Modify existing IOD procedures to require retention of source documentation generated as a result of the participant data audits and used to calculate benefit payments and value the PVFB liability.

IOD Comment: Pending further discussions between OIG and IOD. Current IOD procedures require that source documentation is to be maintained to support participant data audits, the calculation of benefit payments, and the valuation of the PVFB liability. The procedures also identify the specific documentation that is needed based on the status of plan and participant processing. IOD and the OIG have agreed that we should have additional discussions regarding this area of IOD operations. We are reviewing documentation provided by the financial auditors supporting this audit recommendation.

Recommendation 6: Develop, implement, and enforce consistent procedures for reinstating participants into pay status.

IOD Comment: We agree. Procedures covering the reinstatement of participants into pay status will be documented and incorporated into the IOD Procedures Manual. Compliance with the newly written procedure will be monitored to ensure consistency.

Recommendation 7: Enforce policies and procedures related to the maintenance of plan file documentation at the FBAs and headquarters

IOD Comment: We agree This recommendation will be incorporated into the IOD Quality Assurance Initiative and will be reviewed on a regular basis We are reviewing documentation provided by the financial auditors supporting this audit recommendation

Recommendation 13: Enforce policies and procedures that require participants' records in PRISM contain information that is adequately supported in IPS

IOD Comment: We agree The IOD Procedures Manual requires participant records to be adequately supported by either IPS or CCN documentation We are reviewing documentation provided by the financial auditors supporting this audit recommendation

Recommendation 14: Enforce existing policies and procedures related to what information should be captured by FBAs in the participants' records in PRISM

IOD Comment: We agree IOD will more closely review widely distributed instructions about temporal procedural changes to ensure clarity

Recommendation 15: Maintain an adequate audit trail of decisions affecting the integrity of participants' data

IOD Comment: We agree The IOD Procedures Manual will be updated to require that deviations from normal operational procedures be adequately documented

Recommendation 16: Delete invalid duplicate participant records in PRISM and implement necessary controls to prevent the creation of duplicate records in future processing

IOD Comment: We agree We currently have controls in place to ensure that no erroneous payments are made as the result of duplicate participant records We are developing a more efficient automated tool to eliminate duplicate participant records from the PRISM database

Recommendation 18: Properly authorize special check payments in accordance with authorization thresholds established by PBGC

IOD Comment: - We agree. The financial auditors expressed concern with the authorizations of off-cycle payment processing. We are reviewing documentation provided by the financial auditors supporting this audit recommendation.

Recommendation 19: - Develop and implement formal reconciliation procedures that require the reconciling items between PRISM and PLUS records be resolved timely and their resolution be sufficiently documented.

IOD Comment: We agree, and are working towards establishing a reconciliation framework and procedures to ensure appropriate reconciliations between PLUS and PRISM records are taking place on a regular basis.

Recommendation 20: Require formal managerial review and approval of reconciliations between PLUS and PRISM.

IOD Comment: We agree, and will incorporate managerial review and approval in the formal reconciliation procedures.

Recommendation 21: Implement the death match controls.

IOD Comment: We agree. The death match controls were re-instated during the first quarter of FY99.

Recommendation 22: Establish a formal reconciliation process for the plans assumed from the prior paying agents whereby reconciliations are reviewed and approved by an appropriate level of management.

IOD Comment: We agree, and are currently working on the assumption procedures. They will detail the action steps required to complete the assumption process and identify the documentation that must be imaged to reflect actions that were taken.

Recommendation 25: PBGC should implement policies and procedures that would control the assignment of excessive responsibilities, including the development of adequate monitoring of activities performed by individuals and/or systems

IOD Comment: We agree. Procedures to protect appropriate segregation of operational responsibilities have been developed. We have been working with HRD to establish the structure needed to support the operational changes reflected in the procedures. The organizational structure was recently finalized, and positions have been classified and posted. We will begin implementing the new procedures as staffing is completed.