Pension Benefit Guaranty Corporation

Office of Inspector General

Evaluation Report

PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed

March 30, 2011

OIG Eval-2011-10/PA-09-66-1

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

March 30, 2011

To: Joshua Gotbaum
Director

From: Joseph A. Marchowsky Joseph A. Marchowsky
Assistant Inspector General for Audit

Subject: OIG Evaluation Report No. 2011-10/PA-09-66-1, "PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed."

This report presents the results of the subject evaluation. Your written response to the official draft report, dated March 29, 2011, is attached with excerpts and the Office of Inspector General's (OIG) position incorporated into the Finding and relevant Recommendations sections of the report.

We concur with the management decision for each of the report's twelve recommendations. We appreciate the courtesies and cooperation extended to us by members of your staff during this evaluation.

Attachment

Executive Summary

Serious errors and omissions plagued PBGC's efforts to determine the fair market value of plan assets for seven terminated National Steel pension plans. Plan asset audits are intended to verify the value of pension plan assets as of the date of plan termination; this value is important because it can affect the level of benefits to be paid to beneficiaries. For National Steel, a single plan asset audit report was accepted by PBGC in 2004 to establish the asset allocations for seven different pension plans. However, the plan asset audit for the National Steel plans failed to meet applicable professional standards. This occurred because PBGC and its contractor did not exercise due professional care in the conduct of the audit. Further, PBGC did not provide effective oversight for the contractor and accepted and paid for sub-standard and obviously flawed audit work. As a result, neither PBGC nor the plan beneficiaries has reasonable assurance that plan assets have been identified, correctly valued, and allocated to the individual National Steel pension plans.

The value of a plan's assets is important because it is used in calculating retirement benefits. For some plans, increases in the calculated value of plan assets at the date of plan termination result in increased benefits for plan participants. However, for other plans – especially plans such as National Steel in which plan funding falls far short of the calculated guaranteed benefit amount – even relatively large increases in the value of plan assets may not translate into additional benefits for retirees.

Users of this report are cautioned against assuming that OIG's finding and recommendations will result in benefit increases. Because PBGC and its contractors did not perform or document many of the steps necessary to fully validate the value of plan assets, significant further work will be needed for PBGC to determine conclusively whether correction of the errors and omissions OIG identified will result in increased benefits for any National Steel retirees. PBGC has contracted with a Certified Public Accounting (CPA) firm for a detailed reassessment of the value of National Steel's plans assets; this work is currently underway.

PBGC'S Plan Asset Audit Was Seriously Flawed

PBGC paid for a plan asset audit that contained obvious and material errors and omissions in the audit report and in the supporting work papers. Further, many of the required audit procedures were either not performed or not documented. Neither PBGC nor its contract auditor exercised due professional care in the conduct of the audit. Finally, the audit work failed to meet Government Auditing Standards and, as a result, did not provide reasonable assurance about the fair market value of plan assets at the date of plan termination.

Many errors in the plan asset audit were obvious and would have been identified if the report had been subjected to even a cursory oversight review. For example, the audit report showed net assets were $1,436,523,271.58. Three lines later, on the same page, the report's conclusion section showed a different amount, reporting net plan assets of $1,438,375.127.95. Further, the supporting work paper shows yet a third number -- $1,400,302,878.58 -- as net assets. The $38 million difference between net assets as documented in the audit work paper and as reported in the conclusion section of the report is material. Neither the report nor the work papers explained the reasons for the differences in this key number.

Some errors in the plan asset audit report could be identified by comparing what was reported with supporting or corroborating evidence. For example, the audit report states "There were no insurance contracts in the plan." Our review of the Forms 5500 submitted by National Steel showed that the plans held four insurance contracts valued at over $56 million. The audit report also states "No annuities were purchased for participants under the plan." Nevertheless our review of the Forms 5500 submitted by National Steel showed that at least three annuity contracts were purchased for 229 beneficiaries for three of the family of plans.

PBGC's Plan Asset Audit Did Not Comply with Government Auditing Standards

PBGC and its contract auditors asserted in the National Steel plan asset audit report that the audit was conducted in accordance with Generally Accepted Government Auditing Standards. PBGC's contract with the Integrated Management Resources Group, Inc. (IMRG) required that "work products are consistent with Government Auditing Standards…" However, the performance of the plan asset audit suffered from multiple and serious deviations from Government Auditing Standards. Government auditing standards, established by the Comptroller General of the United States, are the professional standards for government auditing that provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence.

Based on our work, we concluded that PBGC leadership did not have a strong commitment to ensuring that audit work was completed in accordance with Government Auditing Standards. Instead, as noted by the Benefits Administration and Payment Department (BAPD) director, assertions about compliance with Government Auditing Standards were considered to be boilerplate and not necessarily relevant to the conduct of the plan asset audits.

PBGC's Oversight of the Contractor was Inadequate

PBGC's oversight of the contract auditors was ineffective in identifying obvious and material errors and omissions in the work IMRG performed on the National Steel plan asset audit. According to the contract, PBGC was to conduct audits of the IMRG's services under the contract, "to obtain reasonable assurance that PBGC policies are being followed and internal controls are in place and are functioning." PBGC personnel responsible for monitoring IMRG's performance included the Contracting Officer's Technical Representative (COTR) and personnel within the assigned Trusteeship Processing Division (TPD).[1]

Although there was no corroborating evidence that PBGC personnel reviewed any of IMRG's work, both the PBGC manager and the PBGC auditor assigned to manage and provide oversight for the National Steel audit signed IMRG's plan asset audit report concurring with the results,

[1] TPDs are divisions, within BAPD, with primary responsibility for activities related to terminated pension plans that PBGC trustees. BAPD currently has eight (8) TPDs. TPD 1 was responsible for the completion of the National Steel plan asset audit.

supporting work papers, and attachments. Neither the PBGC manager nor the PBGC auditor commented on the inadequacies of the contract auditors' work or on the extensive noncompliance with Government Auditing Standards.

PBGC placed tremendous reliance on its contractor and is now experiencing serious and costly problems with the quality and utility of the contract deliverables for which it paid. Many of these issues could have been avoided through effective contract management, including careful contract monitoring, acceptance of deliverables and evaluation of contractor performance. To its credit, after we advised PBGC leadership of the serious issues included in this report, PBGC committed to taking actions to re-evaluate National Steel's plan assets and to improve the effectiveness of its plan asset valuation process.

PBGC has advised that asset values are generally validated by another division of the Corporation after the completion of the plan asset audit. Based on our review of financial records held by the Corporation, the additional independent validation of asset values did not occur for many of the assets of the National Steel plans. Thus, because PBGC did not perform a full validation of asset values and relied on the incorrect and unsupported values provided in the plan asset audit, substantial additional effort will be needed to ensure the integrity of asset allocations to the National Steel pension plans.

PBGC's decision to contract with a CPA firm to re-evaluate the value of plan assets is a positive one. Our recommendations are intended to support that decision and help ensure the effectiveness of PBGC's ongoing effort to calculate a more reliable valuation for plan assets. However, given that the original report was accepted by PBGC in 2004, it is important to note that the work that PBGC is currently doing will not provide the same level of assurance that a properly performed audit, conducted in accordance with Government Auditing Standards, would have provided. The passage of time will prevent PBGC and its new contract auditor from being able to complete many of the audit tests related to the detection of fraud, waste, or abuse. Further, in some instances, outside parties may not have maintained the corroborating records that could be used to assist in the valuation of plan assets. For example, we contacted the firm providing annuities to 229 plan beneficiaries who advised that nearly all of the relevant records have been destroyed.

Our report includes specific recommendations for review coverage to be included in the ongoing re-evaluation of National Steel plan assets. Further, we are making a number of recommendations aimed at reducing the likelihood that future audit products prepared by PBGC or by its contract auditors will suffer from the errors and omissions identified in this report. Users of this report should be aware that the report does not include every instance of error or every possible indicator of risk that was identified during our review. Rather, we have reported the primary types of errors and omissions with the objective of ensuring improvement in future PBGC audits of plan assets and to aid in PBGC's ongoing re-evaluation of National Steel plan assets.

In its March 29, 2011, written response to the official draft report, PBGC expressed agreement with our finding and recommendations. Additionally, PBGC included general comments explaining how the amount of assets in a terminated pension plan may affect the benefits of plan participants. The Corporation noted that, for most people, the amount of plan assets received by PBGC has no effect on the benefits they receive from PBGC[2]. We have incorporated the PBGC response after each recommendation, along with our comments in the OIG Position section. PBGC's response to the official draft is included in its entirety as Appendix C to this report.

We concur with PBGC's proposed corrective actions and have accepted management decision for each of the report's twelve recommendations.

[2] We have not validated and are not expressing an opinion on this assertion.

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Background and Objectives

Background

The Pension Benefit Guaranty Corporation (PBGC) protects the retirement incomes of nearly 44 million American workers in more than 27,500 private-sector defined benefit pension plans. PBGC was created by the Employee Retirement Income Security Act (ERISA) of 1974 to encourage the continuation and maintenance of private-sector defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum. Defined benefit pension plans promise to pay a specified monthly benefit at retirement, commonly based on salary and years on the job.

If a pension plan terminates without sufficient assets to pay all promised benefits, PBGC steps in and becomes trustee. At the time of termination, activities under a pension plan such as benefit accruals and vesting cease. In addition to the terminated plan's assets, PBGC uses its own assets to pay benefits to insure that participants do not lose all their benefits.

Basic pension benefits a participant has earned are guaranteed by PBGC– such as pension benefits at normal retirement age, and disability benefits – up to a monthly limit that is set by law. Generally, the limit is permanently established for each pension plan based on the plan's termination date. For some participants, however, the benefits the employer has promised are greater than the legal limits PBGC can pay.

Minnesota Steelworkers and Miners

The Office of Inspector General (OIG) received a request from U. S. Senators Amy Klobuchar and Al Franken, and U.S. Congressman James Oberstar to review and examine the work of the PBGC regarding Minnesota steelworker pension plans. Beginning in 2002, when PBGC terminated and trusteed several Minnesota steelworker pension plans, the pension benefits of thousands of plan participants were reduced. While there were unique circumstances regarding each plan termination, the Minnesota congressional members were concerned about the perceived disparities between pension plan benefits for these steelworkers. This report is the first in a series of reports we plan to issue to address the concerns of the Minnesota congressional delegation and their constituents. One of the areas the delegation requested the OIG review concerned whether PBGC consistently applied ERISA, as well as its own regulations and policies, when terminating and calculating the benefits related to Minnesota steelworker pension plans. In an effort to address this area of concern, the OIG reviewed selected aspects of PBGC's benefit termination process. This report focuses on PBGC's process to value the assets of the National Steel Corporation[3] family of seven terminated pension plans.

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[3] To adequately address the Minnesota congressional delegations concerns, we decided to focus our evaluation on the terminated steel plans that impacted Minnesota steelworkers and miners, namely the National Steel Corporation and the LTV Steel Company, Inc. Because certain aspects of the termination of the Thunderbird Mining Company's pension plan were in litigation during our review, we did not include this plan (Thunderbird Mining is a subsidiary of the EVTAC Mining Company) within our scope. Selected aspects of the LTV termination will be addressed in a future report.

National Steel Corporation

The National Steel Corporation (National Steel) was one of the largest integrated steel producers in the United States that engaged in the manufacture and sale of a wide variety of flat rolled carbon steel products sold primarily to the automotive, construction, and container markets. National Steel was formed in 1929 through the merger of Great Lakes Steel Corporation, Weirton Steel Corporation and Hanna Iron Ore Company. It purchased Granite Steel Corporation in 1971. Headquartered in Mishawaka, Indiana, National Steel and 41 of its subsidiaries filed for relief under Chapter 11 of the United States Bankruptcy code on March 6, 2002. On May 20, 2003, National Steel sold substantially all of its assets for steel making and finishing and its iron ore pellet operations to United Steel Corporation. National Steel maintained eight defined benefit plans; seven of those plans were terminated on December 6, 2002 and trusteed by PBGC on May 31, 2003. The pension plan for the hourly employees of the American Steel Corporation (the eighth plan) was not trusteed by PBGC; instead, it was terminated as a standard termination since the plan was funded well enough to pay all benefits owed to participants and beneficiaries. The seven National Steel plans trusteed by PBGC are depicted in the table below.

Pension Plan	**Number of Participants/ Beneficiaries [1]**	**Total Liability for Benefits [1]**	**Total Plan Assets per Plan Asset Audit [2]**
Granite City Pension Plan for Chemical Workers	1,360	$161,396,301	$67,603,081
Weirton Retirement Plan	11,962	$505,186,871	$321,363,157
National Steel Corporation Retirement Plan	5,728	$667,007,979	$310,340,803
National Steel Corporation Pension Plan Hourly Employees [3]	10,404	$1,101,896,167	$494,155,641
Granite City United Steelworkers of America Pension Plan	3,830	$382,926,459	$178,567,462
Pension Plan for Salaried Employees of National Steel Pellet	225	$29,374,742	[4] $15,825,012
National Steel Pellet Company Pension Plan for Wage Employees	1,643	$106,558,608	[4]$50,519,972

Table 1: National Steel Corporation pension plans trusteed by PBGC

[1] Data from PBGC's Case Management System, the computerized system for tracking events and inquiries affecting pension plans.
[2] Data from Plan Asset Audit prepared by IMRG, dated July 14, 2003.
[3] This plan was mislabeled as "Great Lakes Hourly Pension Plan" in the plan asset audit report.
[4] The total asset values were incorrectly switched for the National Steel Pellet salaried and hourly pension plans in PBGC's plan asset audit. For purposes of this chart, we reversed the error.

We did not audit the above data derived from the Case Management System and provide no assurance of its accuracy.

Plan Asset Audit

When PBGC becomes the trustee of a terminated pension plan, it must determine the value of the plan's assets. This is necessary to determine if the plan's assets are sufficient to provide plan participants more than their guaranteed benefit. In some cases, the value of plan assets may exceed the amount needed for guaranteed benefits, allowing plan participants to receive a higher benefit amount. In other cases, the value of the plan assets may be less than the value of guaranteed benefits; in these cases, PBGC pays the guaranteed amount to plan participants. PBGC's process for identifying and determining the value of a pension plan's assets is called a plan asset audit.

The purpose of a plan asset audit is to determine the fair market value[4] of the plan's net assets as of the date of the plan termination. To accomplish this task, the audit team should ensure that all plan assets and liabilities have been identified and valued as of the date of plan termination, and take steps to ensure that significant instances of fraud, fiduciary breach, and party-in-interest transactions have been considered. An accurate assessment of the plan's net assets is critical to determining the amount of benefits that can be paid to plan participants.

Accurately valuing a terminated pension plan's assets is one of the most important and fundamental aspects of PBGC's post-trusteeship process and carelessness in this area exposes PBGC to a variety of risks, including, but not limited to:

- Incorrect value of plan assets;
- Failure to identify all plan assets;
- Incorrect value of plan liabilities;
- Insufficient documentation to support valuation;
- Incorrect benefit payments;
- Increased exposure to PBGC's insurance program;
- Increased benefit processing time; and
- Litigation against PBGC.

Additional plan assets, if any, that exist but are not identified as part of the plan asset audit, are not available to PBGC to pay future benefits and unnecessarily increase PBGC's deficit position.

Master Trust. A company that sponsors more than one employee benefit plan may place assets relating to some or all of the plans into one combined trust account, sometimes referred to as a master trust. Each plan has an interest in the assets of the trust, and ownership is represented by a record of proportionate dollar interest or by units of participation. A bank ordinarily serves as the trustee for a master trust and acts as custodian. As part of its custodial duties, the bank issues custodian statements (i.e., bank statements). Custodian statements list the assets held in common

[4] Fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts (29 CFR 4001.2).

by the plans and their values as of the date of the statement. Typically, assets are categorized by type. Appendix B includes detailed information about the various types of plan assets and liabilities, as well as the computation of net asset value.

Most of the assets for the family of terminated National Steel pension plans were commingled into the National Steel Corporation Master Retirement Trust, although some were held outside the trust. National Steel appointed Mellon Bank (now BNY Mellon) as the trustee for this master trust. This was a directed trust, meaning the trustee acted as custodian of the plans' investments and was responsible for collecting investment income. The trustee was also responsible for implementing trust asset transactions as directed by the party named as having discretion to make investment decisions, such as the plan administrator, the plan's investment committee, or the plan's investment advisor.

Annually, on the federal Form 5500 *Annual Return/Report of Employee Benefit Plan* submitted by National Steel, the plan administrator reported the dollar value interest in the master trust. Additionally, each plans' annual financial statement audit included the dollar value of interest and each plan's year-end percentage share of the master trust.

Contract Audit Team. During the time the National Steel pension plans were terminated, PBGC had an on-going labor hour contract with Integrated Management Resources Group, Inc. (IMRG) to conduct audits related to terminated pension plans. PBGC has a long-standing and close relationship with IMRG. While PBGC did not retain records to allow us to determine how many audits IMRG had completed, the contractor reported as an "immense accomplishment" the completion of 430 plan asset audits, 350 participant data audits, 100 plan document audits, and 225 source document audits over a period of years. Further, the contractor reported that PBGC has hired more than twenty-five of IMRG's staff. Prior OIG audit work addressed issues with the qualifications of staff provided by IMRG and with PBGC's oversight of the audit services contract.

During 2003 and 2004, IMRG staff conducted the plan asset audit[5] for the seven terminated National Steel defined benefit plans. The report was accepted by PBGC in April 2004 and was signed by five IMRG auditors, as well as an IMRG project manager and an IMRG audit supervisor.

We were unable to determine the cost of the National Steel plan asset audit, in part because PBGC issued task orders to IMRG but did not retain copies. The total cost of the IRMG audit services contract, under which this plan asset audit was performed, was more than $26 million; the contract's performance period was October 2002 to September 2008.

Objectives

Our overall objective was to evaluate PBGC's actions in terminating and establishing benefits for the Minnesota Steelworker pension plans. For this report, our specific objectives were to determine (1) whether the National Steel plan asset audit met applicable professional standards;

[5] Since the vast majority of the assets for these seven plans were commingled in a single Master Trust, only one plan asset audit was conducted to cover the valuation of the assets for all seven plans.

(2) whether the audit was conducted in accordance with contractual terms and PBGC's established protocols; and (3) the effectiveness of PBGC's oversight and quality control processes for the plan asset audit.

Fieldwork for this evaluation was performed from August 2009 through January 2011. The evaluation was conducted in accordance with the Quality Standards for Inspections established by the Council of the Inspectors General on Integrity and Efficiency, as well as applicable OIG policies and procedures. These standards require that we plan and perform the evaluation to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our evaluation objectives.

Finding and Recommendations

Serious errors and omissions plagued PBGC's efforts to determine the fair market value of plan assets for seven terminated National Steel pension plans and PBGC's plan asset audit failed to meet applicable professional standards. This occurred because PBGC and its contractor did not exercise due professional care in the conduct of the audit. Further, PBGC did not provide effective oversight for the contractor and accepted and paid for sub-standard and obviously flawed audit work. As a result, neither PBGC nor the plan beneficiaries has reasonable assurance that plan assets have been identified and correctly valued and allocated to the individual pension plans.

Users of this report are cautioned against assuming that OIG's findings and recommendations will result in benefit increases. Because PBGC and its contract auditors did not perform or document many of the steps necessary to fully validate the value of plan assets, significant further work will be needed for PBGC to determine conclusively whether correction of the errors and omissions OIG identified will result in increased benefit levels for any National Steel retirees. PBGC has contracted with a Certified Public Accounting (CPA) firm for a detailed re-evaluation of the value of National Steel's plan assets; this work is currently ongoing. Further, the Corporation has committed to correcting its errors, if any, and revising monthly benefit amounts as appropriate.

I. PBGC's Plan Asset Audit Was Seriously Flawed

PBGC paid for a plan asset audit that contained obvious and material errors and omissions in the audit report and in the supporting work papers. Further, many of the required audit procedures were either not performed or not documented. Neither PBGC nor the contract auditors tested or did work to validate the percentages used to allocate commingled assets and liabilities among the seven pension plans; this failing was significant, as variations as small as a single percentage point could have had a material effect on the funding status of the smallest of the National Steel pension plans. Finally, the audit work supporting the plan asset audit failed to meet Government Auditing Standards and did not provide reasonable assurance about the fair market value of plan assets at the date of plan termination.

PBGC and its contract auditors made obvious errors. Many errors in the plan asset audit could have been easily identified if the report had been subjected to even a cursory oversight review. For example, the audit report showed net assets were $1,436,523,271.58. Three lines later, on the same page, the report's conclusion section showed a different amount, reporting net plan assets of $1,438,375.127.95. Further, the supporting work paper shows yet a third number - $1,400,302,878.58 - as net assets. The $38 million difference between net assets as documented in the audit work paper and as reported in the conclusion section of the report is material – more than twice the value of assets allocated to the smallest of the plans. Neither the report nor the work papers explained the reasons for the differences in this key number.

As another example, the dollar values of allocated assets for the National Steel Pellet Salaried Plan[6] and the National Steel Pellet Hourly Plan[7] were incorrectly reversed in the National Steel plan asset audit report. This error should have been obvious to the auditors, as the Pellet Salaried Plan would have been funded at 161% based on the plan asset audit report and, if funded at that level, should not have been terminated by PBGC. Nevertheless, the PBGC auditor and PBGC manager who reviewed and concurred in the report did not identify the mistake. Prior to the time of our review, PBGC had noted this particular error and made necessary corrections in the Corporation's records. However, identification of this obvious error did not lead PBGC managers to review or re-assess the overall quality of the National Steel plan asset audit.

Some errors in the plan asset audit report could have been identified by comparing what was reported with supporting or corroborating evidence. For example, the audit report states "There were no insurance contracts in the plan." Our review of the Forms 5500 submitted by National Steel showed that the plans held four insurance contracts valued at over $56 million.

The audit report also states "No annuities were purchased for participants under the plan." Nevertheless our review of the Forms 5500 submitted by National Steel showed that at least three annuity contracts were purchased for 229 beneficiaries for three of the family of plans.

Other errors were less obvious, but should have been identified and corrected if the audit work had been conducted in accordance with Government Auditing Standards. For example, PBGC and its contract auditors made substantial mistakes in the allocation of assets between the various pension plans.

- The allocation methodology used by PBGC and its contract auditors incorrectly gave credit for the value of assets held by the American Steel Corporation, a pension plan that was terminated under a standard termination agreement, to the seven trusteed pension plans.

- Although the National Steel Pellet Hourly pension plan owned a piece of real estate outside of the commingled master trust, the methodology used by PBGC and its contract auditors incorrectly allocated the value of the real estate across all seven trusteed National Steel plans. That is, the National Steel Pellet Hourly plan was credited with

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[6] Pension Plan for Salaried Employees of National Steel Pellet.

[7] National Steel Pellet Company Pension Plan for Wage Employees.

only a small proportion of the value of the real estate that it owned. While the actual dollar impact of this error was small, the incorrect handling of the National Steel Pellet Hourly plan's asset demonstrates the lack of care shown by PBGC and its contract auditors in allocating assets to the various plans.

Simple tests for the reasonableness of data would have disclosed some errors. For example the plan asset audit calculated slightly less than $3.1 million of accrued interest on fixed assets of approximately $384.9 million, or about .8% -- an interest rate that seems low. Auditor investigation after this simple test would have revealed that PBGC and its contract auditors had failed to accrue interest on $289 million of the fixed assets.

Although National Steel pension plans held six major fixed income accounts, PBGC and its contract auditor calculated accrued interest for only two of the accounts comprising about 25% of the total fixed income portfolio. As a result, none of the seven National Steel plans received credit for interest income earned on four of the six fixed income accounts. Our review relating to these four accounts disclosed that interest income had been received and other interest income was receivable at the date of plan termination. Nevertheless, these amounts were not calculated or allocated to the National Steel pension plans. As a result, asset values for each of the plans were understated.

Further, neither PBGC nor its contract auditors calculated accrued interest relating to cash and cash equivalents, including repurchase agreements and short term deposits and investments that produced interest income. Although statements produced by the custodian bank reflected both interest received and interest receivable relating to these accounts, the interest was not calculated or allocated to the National Steel pension plans, resulting in additional understatement of the plans' asset values. PBGC records do not contain information to allow us to estimate the amount of the understatement, but interest on more than $387 million ($289 million in fixed income and $98 million in cash and cash equivalents) could be material, given the small size of some of the National Steel plans.

According to Generally Accepted Government Auditing Standards (GAGAS),[8] accuracy in audit reports requires that the evidence presented be true and that findings be correctly portrayed. The need for accuracy is based on the need to assure readers that what is reported is credible and reliable. One inaccuracy in a report can cast doubt on the validity of an entire report and can divert attention from the substance of the report. In addition, inaccurate reports can damage the credibility of the issuing organization.

PBGC and its Contract Auditors failed to perform many of the required audit steps. Although the plan asset audit report asserted that the audit was conducted in accordance with GAGAS and the IOD Procedures Manual, our review found no evidence that certain key audit steps had been completed. Many of the omitted steps were steps that would have been useful in

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[8] Unless otherwise noted, references to Government Auditing Standards in this report are from the June 1994 version of the standards which were effective during the time of the performance of the National Steel plan asset audit. The terms Government Auditing Standards and Generally Accepted Government Auditing Standards are used interchangeably in this report.

ensuring that all assets had been identified and in disclosing potential fraud, waste, or abuse. Examples of required audit procedures that were not performed include:

- Independent validation of the custodian's valuation for "hard-to-value" and "non-traditional assets." PBGC and its contract auditors did not consult with experts about how to value these complex investments, as required by PBGC policy. Instead, the auditors simply accepted the valued assigned by the custodian and performed no further testing. For example, the auditors' work did not provide any assurance about the fair market value of venture capital assets valued by the custodian at about $15 million.

- Verification of transfers and unusual transactions. Despite the audit report assertion that PBGC and its contract auditors have reviewed "financial statements for traces of unusual transfers and transactions," we found no supporting evidence that the auditors had verified the legitimacy of transfers from the pension plans. PBGC policy required the auditor to contact banks and insurance companies to obtain statements for one year prior to DOPT and one year subsequent to DOPT, with the purpose of verifying that all transfers are legitimate. Examples of transfers that should have been analyzed include:

    - A $64 million "transfer out" from the National Steel Master Trust Account as reflected in the November 30, 2002 custodian bank statement;

    - Over $192 million transferred from the National Steel Master Trust Account in the year of plan termination, as reflected on the Master Trust Form 5500 for 2002; and

    - Over $2 million in administrative expenses reflected on the Master Trust Form 5500 for 2002 as paid from trust assets during the five month period between plan termination and PBGC's trusteeship of the plan.

- Procedures to identify missing assets. We found no evidence that PBGC or its contract auditors performed audit procedures to ensure that all plan assets had been located or to identify and value additional assets, if any, beyond those listed in the custodian bank statements. The audit services contract required the IMRG auditors to contact likely sources such as insurance companies, investment managers, accountants, and the plan administrator with the purpose of identifying assets not listed on custodian bank statements. However, the contractor's audit work papers showed no evidence that this had occurred. As a result of the auditors' failure to contact sources independent of the custodian, PBGC and the National Steel beneficiaries do not have reasonable assurance that all plan assets were identified and included in the total value of plan assets reported in the audit report.

Review of Forms 5500 to identify material changes in asset value. Although PBGC procedures required that auditors review the Forms 5500 for at least one year prior to DOPT and ending one year after DOPT to ensure all assets are identified and to assess any material changes in asset values, we found no evidence that PBGC or its contract auditors reviewed any of the

Forms 5500 for the seven terminated plans or the Forms 5500 for the National Steel master trust. As a result, errors and omissions that might have been identified through this procedure may have gone unaddressed.

- Confirmation of payables. Audit work papers contained no evidence to indicate that payables were confirmed by PBGC or its contract auditors. Determining the fair market value of a plan's liabilities is an important step in conducting a plan asset audit and an accurate valuation of the plan's liabilities is needed to calculate the plan's net assets. According to PBGC's procedures manual, the auditor should obtain a listing of the plan's accounts payable as of DOPT. The auditor should then confirm payables with creditors by direct confirmation. Based on our review of the work papers and interviews with responsible staff, this required procedure was not performed.

- Steps to identify potential fiduciary breaches, conflicts of interest, and fraud. Audit work papers contained no evidence that PBGC or its contract auditors had performed any of the required procedures intended to identify potential conflicts of interest, fiduciary breaches or fraud. For example, PBGC policy required the auditors to determine whether people other than the named fiduciaries had handled plan investment and whether transactions appeared to be "arms length." Nevertheless, we found no evidence of completion of the required steps to assess risk and identify potential fraud. As a result, PBGC and the National Steel beneficiaries have a reduced level of assurance with regard to the risk of fraud relating to plan assets and liabilities.

- Review of internal controls**.** Relevant PBGC policy required the auditors to establish the existence and degree of internal controls regarding the plan assets. We found no documentation to indicate that either PBGC or its contract auditors had performed this required and critical audit step.

PBGC and its contract auditors allocated assets among the individual plans without validating the allocation percentages. The auditors calculated the fair market value of plan assets for each of the seven individual plans by distributing the "audited" values of assets and liabilities using a set of allocation percentages. These percentages were vital to the accuracy of the resulting numbers, as very small variations in certain percentages could have changed the funding status of the smaller plans. Nevertheless, neither PBGC nor its contract auditors did any work to ensure that the allocation percentages were reliable or to validate the source and use of the percentages. IMRG did not provide work papers to explain the method or rationale for the allocation percentages and dollar values attributed to each plan. OIG interviews with officials from both BAPD and IMRG revealed that neither was able to explain how these percentages of ownership in the master trust assets were derived.

Because the allocation percentages are so important to the calculated fair market value of plan assets at the date of plan termination, any audit done in accordance with Government Auditing Standards, which incorporate by reference the standards of the American Institute of Certified Public Accountants (AICPA), would necessarily include tests of the validity of the allocation percentages. Because the audit report asserts that the audit was done in accordance with Government Auditing Standards, users of the report would be justified in concluding that the allocation percentages had been tested or that the auditors had been satisfied with the results of testing of the internal controls under which the allocation percentages had been developed. However, for the National Steel plan asset audit, we found no evidence of any audit work to address this key element in the computation of the fair market value of plan assets.

PBGC's response to this report discusses an audit program[9] that has been approved by PBGC management for use by a CPA firm to re-perform PBGC's valuation of the plans' assets. Our review of the audit program showed that the CPA firm has been requested to conduct several important analyses of the allocation process. However, we also noted that the audit program did not explain how the CPA firm will address the issue of materiality. If the CPA firm bases its judgments about materiality on the overall value of plan assets, the smallest of the plans could be deemed "immaterial." Given that the National Steel plan assets have been estimated at about $1.4 billion, some auditors might consider a $14 million error to be immaterial. However, since the smallest of the National Steel plans has calculated liabilities of only about $29 million, a $14 million error could be very significant when viewed in comparison to the smallest of the plans and should be deemed material. Thus, we concluded that it is important that the CPA firm consider materiality in light of the smallest National Steel pension plans and that the methods by which materiality is to be calculated be documented in the CPA firm's audit program.

Our review of PBGC policies in effect at the time of the National Steel plan asset audit showed that PBGC guidance did not specifically address the issue of validating allocation percentages. Our review of current PBGC policy shows that it continues to be silent on the topic of validating allocation percentages. The National Steel plan asset audit is not unique in the auditors' failure to validate allocation percentages. Given the detailed guidance that PBGC has developed to address other aspects of the plan asset audit process, it would be prudent for PBGC to develop and implement specific audit procedures to ensure the integrity and fairness of allocation percentages used in situations where plan assets have been commingled.

II. PBGC's Plan Asset Audit Did Not Comply with Government Auditing Standards

PBGC and its contract auditors asserted in the National Steel plan asset audit report that the audit was conducted in accordance with GAGAS. PBGC's contract with IMRG calls for audit work to be "consistent with the government auditing standards...." However, both the performance of the plan asset audit and the quality assurance program under which it was performed suffered from multiple and serious deviations from government auditing standards. GAGAS are the professional standards for government auditing that provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence. The general standards apply to all audit organizations, both government and nongovernment, conducting audits of government organizations, programs, activities.

Based on the pervasive nature of the errors and omissions in the audit report itself and on our interviews with responsible contractor and PBGC personnel, we concluded that little emphasis

[9] Audit programs comprise a listing of the procedures to be performed as part of an audit as well as other information necessary to guide the engagement. Procedures for calculating materiality and documenting the auditors' judgment about materiality are frequently included in audit programs.

had been placed on ensuring the truth of the audit report's assertion that the audit was conducted in accordance with GAGAS. For example, during our interview with the PBGC auditor responsible for monitoring contactor performance on the National Steel plan asset audit, the auditor noted that "the use of the standards sort of fell through." In response to a question about whether PBGC ensured that contract auditors performing the National Steel plan asset audit followed government auditing standards (colloquially known as the "Yellow Book" because of its yellow cover), the PBGC auditor with responsibility for oversight stated:

> *It was interesting that a report template we used stated the work was done in accordance with Yellow Book standards, because during the time of the National Steel plan asset audit we were not performing the work in accordance with Yellow Book standards.*

By including a statement of compliance with generally accepted government auditing standards in its National Steel plan asset audit, PBGC and its contract auditors are affirmatively asserting that the report and all supporting work papers were prepared in accordance with these standards and that the auditors followed all applicable standards during the audit. The compliance statement should be qualified in situations in which the auditors did not follow an applicable standard. However, the pervasive nature of the errors and omissions in the audit report, as well as the comments and observations made by the PBGC employees and leaders with responsibility for the audit make it clear that neither PBGC nor its contract auditors were performing their responsibilities in accordance with applicable professional standards. Thus, PBGC should formally withdraw the National Steel plan asset audit report and provide appropriate notice of the withdrawal on PBGC's public website.

In addition to the serious errors and omissions already discussed, we identified additional deviations from standards.

Incomplete Audit Work Papers. Neither PBGC nor its contract auditor maintained a complete record of the auditors' work, whether in the form of work papers or in any other written form. GAGAS fieldwork standards for performance audits require"

> *Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditors' findings and conclusions. A record of the auditors' work should be retained in the form of work papers. Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.*

A significant part of any audit entails obtaining and evaluating evidence that ultimately supports the auditors' judgments and conclusions pertaining to the audit objectives. Documents gathered and conclusions reached during the audit are maintained as work papers. Working papers serve three purposes - they provide the principal support for the auditors' report, aid the auditors in conducting and supervising the audit, and allow others to review the audit's quality. Audit work papers for the National Steel plan asset audit demonstrated that the audit team did not perform a robust, complete, and thorough audit. Our review showed an insufficient number of work papers to support the auditors' findings; further, the work papers did not always have a logical, sensible relationship to the findings. The work papers contained only a small proportion of the evidence required to support a plan asset audit for a large plan termination, if the audit was performed in accordance with applicable standards.

The work papers that PBGC and its contract audit maintained often failed to support the audit report as written. For example, the following table shows three instances where the asset totals presented in the report did not agree with the totals reflected in the underlying work papers and neither the report nor the supporting work paper explained the reasons for the differences in this number. The differences are material; each totals more than twice the value of assets allocated to the smallest of the seven plans.

Work Paper (WP) Number & Title	Amount Reflected In IMRG PAA Report	Amount Reflected In IMRG Work Papers	Difference
WP VIII, *Net Assets*	$1,436,523,271.58	$1,400,302,878.58	**$36,220,393**
WP VIII, *Total Assets*	$1,438,375,127.95	$1, 403,332,565.18	**$35,042,562**
WP IX, *Total Assets*	$1,438,375,127.95	$1,403,332,565.18	**$35,042,562**

Table 2: Examples of asset total discrepancies between IMRG's report and supporting work papers

Additionally, for five of the seven pension plans, the master trust allocated amounts depicted in the plan asset audit report did not agree with the values contained in the supporting work paper (see table below). Neither the report nor the supporting work paper explained the reasons for the differences in these allocated amounts.

Plan Name	PBGC Case No.	IMRG Audit Report (as of 12-6-02)	IMRG Work Paper IX (as of 12-6-02)
Granite City Pension Plan for Chemical Workers	19761000	**$67,603,080.52**	**$66,237,297.08**
Weirton Retirement Program	19761400	$321,363,157.42	$321,363,157.43
National Steel Corporation Retirement Program	19836900	**$310,340,803.13**	**$306,347,498.98**
National Steel Corporation Pension Plan Hourly Employees	19837000	**$494,155,640.95**	**$470,818,075.62**
Granite City United Steelworkers of America Pension Plan	19837100	**$178,567,462.06**	**$172,609,905.52**
Pension Plan for Salaried Employees of National Steel Pellet	19761300	**$15,825,011.52**	**$15,436,658.22**
National Steel Pellet Company Pension Plan for Wage Employees	19837400	$50,519,972.35	$50,519,972.35
	TOTALS	**$1,438,375,127.95**	**$1,403,332,565.20**

Table 3: Examples of allocation discrepancies between IMRG's report and supporting work papers

The National Steel plan asset audit report showed Due and Unpaid Employer Contributions (DUEC) of $35,042,562; while the supporting work paper showed a DUEC value of $36,220,393 -- a difference of $1.1 million. As with the other discrepancies, neither the report nor the supporting work paper explained the reasons for the differing amounts reported for this receivable.

The National Steel plan asset audit work papers did not contain the objectives, scope, and methodology of audit work performed, including any sampling criteria used. The lack of these critical elements, which are required by Government Auditing Standards, makes it exceptionally difficult to understand or assess the work performed by the auditors. Without complete work papers, auditors who follow are unable to rely on the conclusions reached by the National Steel plan asset audit team.

Based on the scant number of work papers filed in PBGC's official system of record, Image Viewer, we were unable to determine whether:

- The auditors simply failed to accomplish the vast majority of the audit steps required to complete the plan asset audit;

- Whether the auditors chose to ignore Government Auditing Standards concerning documenting the work performed; or

- Whether both PBGC and the contract auditors did not take proper care to safeguard and maintain the vast majority of the work papers.

During an interview with IMRG personnel, IMRG officials explained they never kept copies of the National Steel plan asset audit work papers. The contractor advised that PBGC had stated that the work papers were the property of PBGC and should be left with PBGC at the completion of the audit. During an interview with OIG, the president of IMRG stated she was surprised that PBGC could not provide IMRG's work papers for these audits. She stated that her staff generated lots of work papers related to these projects and she could not understand why PBGC was unable to locate these documents. PBGC officials advised that we had been provided all existing work papers related to the National Steel plan asset audit.

Effective use of work papers supports the auditors' conclusions, allows for quality control reviews and is a fundamental characteristic of a professional auditor. Neither PBGC nor its contract auditor provided adequate work paper support for the issued plan asset audit report.

No evidence of compliance with other mandatory standards. Due to the absence of required work paper documentation, neither the contractor nor PBGC provided evidence to support compliance with Government Auditing Standards requirements during the National Steel plan asset audit, including:

- No evidence that the audit engagement was adequately planned. Many of the errors and omissions noted previously would not have occurred if the audit had been properly planned, in accordance with Government Auditing Standards.

- No documentation of significant conclusions and judgments. Because neither PBGC nor its contract auditors ensured documentation of key conclusions, others -- including those who review the work after the fact -- do not have the necessary information to allow reliance on the report's conclusions.

- Limited evidence of supervisory review of work performed. Although the audit work papers contain some evidence of IMRG's supervisory sign-off on certain analyses, the pervasive nature of the obvious errors and omissions make it highly unlikely that audit work was subject to thoughtful supervisory review.

- No evidence of work to obtain assurance of compliance with laws and regulations. Government Auditing Standards require that an audit be designed to provide reasonable assurance of compliance with relevant laws and regulations.

- No evidence of compliance with standards for continuing professional education. Our review disclosed that neither IMRG nor PBGC maintained evidence documenting that contract auditors, who performed the National Steel plan asset audit, earned the required continuing professional education (CPE) hours to support their professional proficiency.

- No external peer review. Neither the contract audit organization nor PBGC had complied with the requirement for an independent external peer review. Government Auditing Standards require that each audit organization conducting audits in accordance with these standards have an appropriate internal quality control system in place and undergo an external quality control review (i.e., a peer review).

III. PBGC's Oversight of the Contractor was Inadequate

PBGC's oversight of the contract auditors was ineffective in identifying obvious and material errors and omissions in the work IMRG performed on the National Steel plan asset audit. PBGC was required to monitor IMRG's performance in accordance with the technical performance aspects of the audit services contract. PBGC personnel responsible for monitoring IMRG's performance included the Contracting Officer's Technical Representative (COTR) and personnel within the assigned Trusteeship Processing Division (TPD).[10]

As stated in PBGC Directive FM 15-1, the COTR's major responsibilities were to monitor the contractor's performance to ensure compliance with the technical performance aspects of the contract; ensure that deliverables were acceptable; maintain documentation and records for actions taken; and ensure invoices were proper prior to payment. TPD personnel are the subject matter experts in conducting plan asset audits and are assigned the overall responsibility for the completion of these audits. Therefore, they should play a significant role in assisting the COTR

[10] TPDs are divisions within BAPD with primary responsibility for activities related to terminated trusteed pension plans. BAPD currently has eight TPDs. TPD 1 was responsible for the completion of the National Steel plan asset audit.

in effectively monitoring the contractor's performance. The TPD auditor is typically involved with the contract auditors on a day-to-day basis and should be reviewing the contractor's work papers and final report for such things as accuracy of analyses, adequacy and relevancy of work performed, and sufficiency of support for conclusions.

During our evaluation, we identified pervasive weaknesses in PBGC's oversight of the contract auditors' work:

- No Evidence of COTR Monitoring. PBGC provided no COTR records demonstrating any monitoring or oversight of IMRG's work during the performance period of the National Steel plan asset audit. That is, PBGC provided no progress reports, no documentation to support any feedback from PBGC personnel who worked directly with the contractor, and no documents regarding the inspection and acceptance of the contractor's deliverables. While PBGC record retention policies call for COTR records for this contract to be forwarded to the Contracting Officer and maintained until March 2015, PBGC did not provide any COTR records for three of the five assigned COTRs[11] for the IMRG contract. Although a few files were located for the other two COTRs, we found no evidence that any of the five COTRs had monitored IMRG's performance. Nevertheless, when this contract was closed out in 2008, the final COTR rated the contractor's performance as "Outstanding," despite the absence of any documented support for this rating.

- No Evidence of TPD Monitoring. PBGC officials advised that they were unable to locate any evidence of TPD monitoring. Other than the uncorroborated assertions of the TPD auditor assigned to the audit, we found no evidence of such monitoring. There were no written products to show whether IMRG's work complied with contract performance standards related to technical quality, timeliness, demonstration of specific expertise, and overall performance.

  Furthermore, in reviewing the audit work papers, we noted that TPD personnel did not initial and date any of the work papers, as evidence of PBGC's review of these documents, nor did the work papers contain any review comments or notes authored by PBGC personnel. The TPD auditor who concurred in the report shared the following as it relates to the review of IMRG's work papers, **"**My review of plan asset audits in particular consisted of reading the report; reviewing work papers to determine what was done; and performing recalculations. … Although I did not sign off on each work paper reviewed, my concurring on the report, in my view, supports that I looked at everything."

Based on the numerous obvious inaccuracies and the lack of support for IMRG's audit conclusions, we concluded that the undocumented review performed by the TPD auditor was, at best, inadequate.

Although there was no corroborating evidence that PBGC personnel reviewed any of IMRG's work on the National Steel plan asset audit, both the TPD manager and auditor assigned to

[11] During the time period of the IMRG contract under which the National Steel plan asset was performed, five different COTRs had been assigned responsibility for contract monitoring.

manage and provide oversight for the audit signed IMRG's plan asset audit report, concurring with the results and supporting work papers and attachments. Neither the PBGC manager nor the PBGC auditor commented on the inadequacies of the contract auditors' work or on the extensive noncompliance with Government Auditing Standards.

Based on our interview with BAPD personnel, PBGC's plan asset audits had included a statement of compliance with government auditing standards for years, without regard to whether auditors actually complied with the standards and without an effort to evaluate that compliance. The BAPD Director advised that audit work was performed as it always had been, without regard to the standard cited in the audit report. We concluded that PBGC leadership has historically placed little emphasis on the need to conduct audit work in accordance with professional auditing standards, with a resulting negative effect on the work of PBGC's contract auditors and PBGC audit staff.

IV. PBGC Personnel Ultimately Responsible for Shoddy Contract Work

Although a contractor performed much of the National Steel plan asset audit work, PBGC was ultimately responsible for ensuring the contractor provided a quality product in accordance with applicable auditing standards. In our opinion, both PBGC and its contract auditor failed in their responsibility for ensuring that the National Steel plan asset audit was conducted in accordance with applicable professional standards.

Factors that support the contract auditor's responsibility for ensuring the quality of work include:

- Seven IMRG employees, including the IMRG audit supervisor and the IMRG Project Manager signed the National Steel plan asset audit report;
- IMRG was paid under a contract that called for reports to be prepared "on the basis of customary and reasonable accounting and auditing standards" and that required work products to be "consistent with the generally accepted government auditing standards;"
- IMRG claimed the audits as being their own. For example, in a progress report they referred to their own accomplishment in "the **completion** (emphasis added) of … 430 plan asset audits."

Factors that support PBGC's responsibility for ensuring the quality of work include:

- The audit report was issued on PBGC letterhead;
- IMRG auditors were not authorized to contact the plan sponsor, insurance companies, or asset managers;
- PBGC retained the work papers and prohibited IMRG from retaining copies;
- PBGC senior leadership considered IMRG employees to be support members of a team working to complete audits on behalf of PBGC;
- IMRG asserted that IMRG personnel were contracted professional staff being utilized by PBGC to perform the procedures assigned to them; and
- PBGC personnel assigned the work to be done, provided the documents to be examined, advised the specific procedures to be used, and made changes to the report as they judged appropriate.

PBGC is ultimately responsible for ensuring the quality and integrity of the National Steel plan asset audit; however, IMRG is also responsible for ensuring that work for which the contractor is paid meets the standards of the contract – in this case, audit work performed consistent with government auditing standards and PBGC's internal guidance. Based on the extensive errors and omissions in the National Steel plan asset audit and supporting work papers, both PBGC and IMRG failed to exercise due professional care as required by government auditing standards.

V. PBGC's Corrective Actions Initiated During OIG's Review

PBGC placed tremendous reliance on its contractor and has experienced serious and costly problems with the quality and utility of the contract deliverable for which it paid. Many of these issues could have been avoided through effective contract management, including careful contract monitoring, acceptance of deliverables and evaluation of contractor performance. To its credit, after we advised PBGC leadership of the serious issues included in this report, PBGC committed to taking actions to re-evaluate National Steel's plan assets and to improve the effectiveness of its plan asset valuation process.

In February 2011, PBGC contracted with a certified public accounting firm to (1) perform procedures to provide management with evidence that all assets have been identified; (2) determine if there were any insurance contracts; (3) validate the allocation of assets in the Master Trust to ensure that each plan was allocated the appropriate amount as of the date of plan termination; (4) determine if there were any improper transfers of assets; and (5) determine the fair market value of plan assets as of the date of plan termination.

The CPA firm will face a number of difficulties in completing the work set forth by PBGC. First, the passage of time will affect the ability of the CPA firm to evaluate transfers of assets for propriety. Information about the insurance contract and the annuity contracts may be impossible to obtain. As part of our review, we contacted the company providing the annuities and were told that many of the records supporting the payment of annuities were no longer available. Finally, some or all of the investment managers responsible for assets of the National Steel pension plan may have discarded or archived relevant records. It is likely that some of the omitted procedures that should have been performed originally cannot be performed effectively at this time. Nevertheless, PBGC is to be acknowledged for its attempt to provide assurance about the fair market value of plan assets for the National Steel pension plans.

PBGC has also taken other actions in response to our preliminary findings, including:

- Moving from a labor-hour to a fixed price contract vehicle for plan asset audit, a change that PBGC believes will place more responsibility on the contractor for submission of a quality product;

- Creating a position of Auditor Technical Reviewer with applicable training on the technical reviewer's role in support of the COTR;

- Initiated a process through which each TPD develops and implements an action plan to address the quality of work; and

- Reviewing plan asset audits completed over the last 2 years, with the objective of using identified deficiencies to train reviewers and staff and to update procedures.

In addition to the above actions initiated by the corporation, in August 2010, PBGC's Chief Operating Officer issued a memorandum to senior BAPD personnel clearly enumerating his expectations that senior BAPD personnel would:

- Follow PBGC and BAPD policy, procedures, and processes;

- Ensure the federal employees and contractors who do work that BAPD is responsible for all follow PBGC policy, procedures, and processes;

- Accomplish work with a reasonable level of quality;

- Not sign a document that does not meet the above expectations and do what is necessary to correct the work.

- Clearly document and obtain approval for deviations to policy, procedures, and processes; and

- Maintain documentation of poor work performed by contractors.

If senior BAPD personnel meet the expectations set forth in the letter, the quality and accuracy of work to value plan asset audits will almost certainly be greatly improved.

The PBGC Director has made changes in the organizational structure of BAPD's leadership. The position of Chief Operating Officer has been merged into the role of Deputy Director, creating the position of Deputy Director for Operations (DDO). According to the PBGC Director, this change will give the Deputy Director direct management oversight over BAPD. As part of that responsibility, the DDO is planning a strategic review of the structure, processes and procedures of PBGC's current benefits processing and payments. The work is to be performed by an external contractor.

Recommended Actions

We recommend PBGC initiate the following corrective actions:

1. Formally withdraw the National Steel plan asset audit report and post notice of withdrawal on PBGC's external website. The notice is to remain on the website until the new National Steel plan asset report is completed and accepted by PBGC with a statement in the new report regarding the withdrawal of the prior asset audit report.

PBGC Response: Management will withdraw the current National Steel Plan Asset Audit report and post a notice on the PBGC website to let participants know that the asset audit is being redone. The notice will also state that the existing benefit determinations remain in effect and should be relied on unless or until they are changed.

OIG Position: We concur with the management decision.

2. Ensure that the CPA's ongoing re-evaluation addresses each of the omitted procedures, including but not limited to accrual of interest on fixed income and cash and cash equivalents; independent validation of the custodian's valuation for hard-to-value and nontraditional assets; verification of transfers and unusual transactions; confirmation of payables; and review of internal controls.

   PBGC Response: Management has directed the CPA firm to include OIG's recommendation into their testing. As OIG's report notes, the CPA firm will face difficulties, in part, due to the passage of time. To the extent that testing can be performed, the independent CPA firm assigned to National Steel will test the areas cited in the recommendation.

   OIG Position: We concur with the management decision.

3. Ensure that the CPA's ongoing re-evaluation includes steps to contact likely sources, such as insurance companies, investment managers, accountants, and plan administrators for the purpose of identifying assets not listed on custodian bank statements. To the degree that such contacts are no longer possible (e.g., the asset manager is no longer in business), develop and perform alternative procedures to provide assurance that all assets have been properly identified, collected, and allocated to the National Steel plans.

   PBGC Response: Management has directed the CPA firm to include the OIG's recommendation in their testing. Management has reviewed and approved the CPA firm's audit program that includes the required steps or alternative testing to ensure that all assets for the Plans have been properly identified, collected, and allocated to the National Steel plans.

   OIG Position: We noted that the audit program approved by PBGC management did not address how the CPA firm would consider materiality in its testing of asset allocation. As noted in this report, we believe that it is important that the new CPA firm consider materiality in light of the smallest National Steel pension plans and that the methods by which materiality is to be calculated be documented in the CPA firm's audit program. As long as the CPA firm considers the smallest of the National Steel plans in its materiality calculations, we concur with the management decision.

4. In the event that the CPA is unable to perform the procedures that were required at the time the plan asset audit was issued, ensure that the CPA's ongoing re-evaluation includes alternative steps to identify potential fiduciary breaches, conflicts of interest, and fraud.

PBGC Response: Management has directed the CPA firm to include the OIG's recommendation in their testing. Management is reviewing the CPA firm's audit program's alternative procedures to identify potential fiduciary breaches, conflicts of interest, and fraud.

OIG Position: We concur with the management decision.

5. Ensure that the CPA's ongoing re-evaluation includes validation of the allocation percentages used to distribute commingled assets among the various plans. Additionally, ensure that assets are distributed consistently with the type of ownership. That is, for items such as insurance contracts, annuity contracts, and real estate that are not owned in common with the other National Steel plans, allocate the value to the plan that owns the asset.

   PBGC Response: Management has directed the CPA firm to include the OIG's recommendation to ensure that specific issues identified are taken into account during their testing. Testing the allocation of assets for the National Steel Plans is a central task of the reevaluation PBGC is asking the CPA firm to perform. Management has reviewed and approved the specific audit programs of the CPA firm, including alternative procedures for testing of the allocation of assets among the National Steel Plans.

   OIG Position: We concur with the management decision, contingent upon the CPA firm's use of an appropriate materiality calculation as noted in the OIG position for recommendation 3 above.

6. Use the results of PBGC's review of plan asset audits completed over the last two years to enhance training and modify guidance as warranted.

   PBGC Response: Management will incorporate the results of the two year look-back testing into the plan asset audit course that is scheduled to be developed during FY 2011. Management will also provide additional guidance to auditors through updated procedures or references in the Auditor's Technical Manual where appropriate.

   OIG Position: We concur with the management decision.

7. Ensure that technical monitors are aware of their responsibility to review the work performed by contract auditors, including an assessment of whether the conclusions in the audit report are supported by the results of audit testing, a comparison of the work performed by the contract auditors to the work mandated in PBGC protocols, and review and resolution of material variances disclosed during the course of an audit.

   PBGC Response: Management held a two-day workshop with the Auditor Technical Reviewers (technical monitors) on January 12 and January 31 to discuss their responsibilities in the review and evaluation of contractor audits. The Contracting Officer's Technical Representative will meet with the Auditor Technical Reviewer and a representative from the Trusteeship Processing Division Management Team, where appropriate, to re-emphasize the responsibilities each time a new asset evaluation is undertaken.

OIG Position: We concur with the management decision.

8. Within BAPD, develop a department-level "robust" quality assurance program aimed at ensuring plan asset valuations are performed in accordance with applicable procedures and standards.

   PBGC Response: PBGC is in the process of developing a department-level, robust quality assurance program aimed at ensuring plan asset valuations are performed in accordance with applicable procedures and standards. The program will consist of several parts including: (a) appropriate work reviews; (b) improved and targeted training; (c) improved procedures; (d) improved lessons learned and related communications and (e) a formal assessment of process adherence through a Product and Process Quality Assurance Program. A contract award for Product and Process Quality Assurance has already been made.

   Additionally, PBGC is undertaking a strategic review of BAPD, including its processes, personnel, and organization. This review is being led by the Deputy Director for Operations, assisted by PBGC staff as well as outside experts. The goals of this review are to assess and, as appropriate, refine BAPD's operational strategy; align the structure, systems and processes; and improve customer service (quality of products, services, and timeliness) and accountability. The procurement for this strategic review is underway.

   OIG Position: We concur with the management decision.

9. Enhance and formalize training efforts for auditors to better guide them on appropriate planning, risk assessment, and scope of procedures to be performed as part of the audit program. Further, enhanced training on illiquid investments, fiduciary breaches, and other special situations should be provided.

   PBGC Response: Management will re-look at the current auditor curriculum for BAPD auditors to address the items outlined in OIG's recommendation. Where appropriate, management will seek outside consultants in developing training for these items.

   OIG Position: We concur with the management decision.

10. Develop and maintain a process to share "lessons learned" and best practices in a formal and consistent manner to ensure that all appropriate personnel become aware of best practices and are able to use them in future audits.

    PBGC Response: Management has begun to use Auditor's Quarterly meetings and monthly Auditor Technical Reviewer meetings to formalize the lessons learned and best practices. Specific meeting notes or topics will be included in the Auditor's Technical Manual or Portal for future reference.

OIG Position: We concur with the management decision.

11. Expand the current written procedures to include procedures and a checklist of factual and legal items for identifying all available assets, including those not custodied with the primary custodian bank; for example: insurable assets; intellectual property; accounts held by asset custodians elsewhere (e.g., at a prime brokerage firm); and potential plan assets that may be less obvious than other plan assets.

    PBGC Response: Management will update its procedures manual and applicable audit programs to include the items noted in OIG's recommendation.

    OIG Position: We concur with the management decision.

12. Develop and implement specific audit procedures to ensure the integrity and fairness of allocation percentages used in situations where plan assets have been commingled.

    PBGC Response: Management is working to update its procedures manual and train staff on how to audit plans where an allocation of assets is needed.

    OIG Position: We concur with the management decision.

Appendix A – Scope and Methodology

The Office of Inspector General (OIG) received a request from U. S. Senators Amy Klobuchar and Al Franken, and U.S. Congressman James Oberstar to review and examine the work of the PBGC regarding Minnesota steelworker pension plans. This report is the first in a series of reports we plan to issue to address the concerns of the Minnesota congressional delegation and their constituents. One of the areas the delegation requested the OIG review concerned whether PBGC consistently applied ERISA, as well as its own regulations and policies when terminating and calculating the benefits related to pension plans of Minnesota steelworkers. In an effort to address this area of concern, the OIG reviewed selected aspects of PBGC's benefit termination process. This report focuses on PBGC's process to value the assets of the National Steel Corporation family of seven terminated pension plans.

Fieldwork for this evaluation was performed from August 2009 through January 2011. The evaluation was conducted in accordance with the Quality Standards for Inspections established by the Council of the Inspectors General on Integrity and Efficiency, as well as applicable OIG policies and procedures. These standards require that we plan and perform the evaluation to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our evaluation objectives.

To achieve our evaluation objectives, we performed a detailed review of the Plan Asset Audit of National Steel Pension Plans dated July 14, 2003 and accepted by PBGC in April 2004. PBGC's audit - the subject of our review - was conducted by contract auditors, under PBGC oversight, and was intended to determine the fair market value of plan assets at the date of plan termination for seven terminated National Steel pension plans.

In addition to performing a detailed review of the issued plan asset audit report and supporting workpapers and attachments, the OIG evaluation team:

1.) Identified and analyzed the laws, regulations, professional standards (including Government Auditing Standards and standards promulgated by the AICPA), and PBGC policy and guidance applicable to the plan asset audit process and to oversight of contractors.
2.) Obtained and analyzed PBGC's contract with IMRG for audit services to be provided between 2002 and 2008, as well as key documentation, progress reports, and other correspondence and documentation pertaining to the conduct of the National Steel Plan asset audit.
3.) Interviewed the BAPD Director, BAPD Deputy Director, various BAPD managers, the COTR as of the date of contract closeout, the TPD auditor who concurred with the issued report, various PBGC personnel, IMRG leadership and staff, FOD personnel with responsibility for accounting for and valuing assets after trusteeship, and responsible personnel at the insurance companies holding insurance policies and annuity contracts for National Steel pension plans.
4.) Performed evaluation work at IMRG offices to obtain the contractor's perspective on the conduct of the National Steel plan asset audit as well as other audit work performed

under the auditing services contract, reviewed contractor personnel records for the auditors who worked on the National Steel plan asset audit, and evaluated the contractor's processes for ensuring compliance with government auditing standards.

5.) Reviewed and analyzed Forms 5500 for the Master Trust and for each terminated and trusteed National Steel pension plan for plan years 2002 and 2003. Forms were obtained from PBGC and from the publically available website FreeERISA.com.
6.) Reviewed and evaluated Mellon Bank custodian statements, to the extent available, to identify assets or income that may have been omitted from the plan asset audit and to identify unusual transactions, if any.
7.) Conducted detailed testing of the contract auditors' workpapers supporting the plan asset audit, with emphasis on tests of completeness and valuation. We recalculated spreadsheets, tested equity and fixed income valuations against publicly available sources such as Yahoo! Finance, and compared the inventory of plan assets to other available information including Forms 5500.
8.) Reviewed previously issued OIG Audit Reports Number 2007-8/CA-0033-1 and 2008-4/CA-0033-2, "Report for Costs Incurred by IMRG under Contract PBGC01-CT-03-0652 for Fiscal Years ended September 30, 2003, 2004, 2005, and 2006" and "Report on PBGC's Contract Administration of the IMRG Contract CT-03-0652," respectively. These audits had been performed to evaluate IMRG's compliance with selected contract terms and to assess PBGC's oversight of IMRG. Our current review placed special emphasis on the open audit recommendations where PBGC has yet to implement corrective action.
9.) Reviewed a report commissioned by PBGC and performed by the Hewitt Corporation to evaluate BAPD's post-trusteeship activities, including the plan asset audit process. Additionally, we requested PBGC to provide the status of actions taken to address recommendations included in the Hewitt report. We adapted some of the Hewitt recommendations for use in this report.

Our evaluation was limited in several ways due to PBGC's failure to maintain important information about the National Steel plan asset audit and its oversight. First, our evaluation was limited because PBGC used a task order process to assign work to its contract auditors, but did not maintain the task orders. Thus, we were unable to definitively determine exactly what amount PBGC paid to IMRG for the National Steel plan asset audit. Additionally, as noted in our evaluation report, the TPD auditor, the COTR, and the Contracting Officer each failed to maintain complete records of contract oversight, impeding our ability to determine exactly why PBGC accepted and issued the flawed audit report.

Appendix B – Plan Assets, Liabilities, and Net Asset Value

Types of Plan Assets

Pension plans can include several types of assets as follows:

- Cash and cash equivalents are liquid assets. Cash equivalents include money market fund accounts, checking accounts, savings accounts, and certificates of deposit. Short-term investment funds (STIF's) are considered cash equivalents since the unit value is $1.00.

- Investment accounts and securities. These include stocks, bonds, foreign stock and bonds on foreign exchanges, commodity trading, derivatives (futures), and pooled and mutual funds.

- Non-traditional assets. Theses investments are not traded on a national exchange such as the New York Stock Exchange (NYSE). Real estate, limited partnerships, common/collective funds, and joint ventures are examples of such assets.

- Insurance contracts. Some plans are funded either partially or fully through an insurance company contract.

- Plan receivables generally include participant loans, Due and Unpaid Employer Contributions (DUEC), and assets not settled (pending sales).

- Interest. Many plan assets accrue interest income, which is considered a plan asset. Examples include interest on a Money Market account or dividend payments on stock.

In some cases the audit team must address assets that have been merged or included in master trusts where the assets of several plans are combined and under the common control of a single custodian.

Types of Plan Liabilities

Plans also include the following basic types of liabilities:

- Benefits payable. These include retroactive retiree benefit payments due to participants that are past due as of DOPT, including payees who were underpaid and participants who were never placed into pay status (Pre-Termination Plan Liabilities).

- Expenses payable. These include allowable expenses under the plan that are incurred for services such as actuarial, administrative, or legal services but not paid as of the DOPT.

- Assets purchased but not settled. These are assets that have been purchased but not settled as of DOPT. These represent a liability since the funds for the purchase have not been remitted as of DOPT.

Net Asset Value

PBGC determines the net value of plan assets by subtracting the total fair market value of plan liabilities as of DOPT from the total fair market value of plan assets as of DOPT.

Appendix C – Agency's Response

PENSION BENEFIT GUARANTY CORPORATION'S RESPONSE TO AUDIT REPORT

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

Office of the Director

March 29, 2011

To: Rebecca Anne Batts
Inspector General

From: Josh Gotbaum

Subject: **2003-2004 Asset Audit of National Steel Pension Plans**

Eight years ago, after National Steel declared bankruptcy and its pension plans terminated – devastating some 35,000 employees and their families – PBGC assumed responsibility for those plans and for paying benefits. To do this, PBGC took over both the assets and the obligations of those plans. Sadly, in one part of its task – auditing to ensure that PBGC had obtained all the plan assets and that they were properly allocated to each plan -- both PBGC and its contractors did a bad job.

Although it remains unclear whether any National Steel pensioners suffered any reduced benefits as a result of the audit, we are grateful to your office for uncovering and reporting these failings, because doing so enabled us to correct them. As you note in the report, PBGC has already started to make those corrections. In fact, soon after I arrived at PBGC, we took a range of actions to correct any mistakes in anyone's pension benefits, and to make changes to ensure they never happen again.

Your report notes that neither you nor PBGC yet knows whether any National Steel pensioners suffered any reduced benefit as a result of the asset audit. We are working now to find this out. Our hope is that none did – *but if anyone lost even a dime, their benefits will be corrected and they will be paid back with interest.* When we are done, we expect that no one will have been shortchanged.

We agree with all of your findings and recommendations in this report and have begun implementing them. PBGC is charged with a mission: helping provide security to those whose pensions (and other benefits) have been taken away. Doing that work in a substandard way undermines that security, even if it results in no one's benefit being wrongly determined. PBGC is embarrassed and saddened that this happened. We have resolved to set things right, and we will do so.

Correcting the Errors of the Past

PBGC started last summer developing a plan of action to redo and correct any errors in the asset audit. We have hired a public accounting (CPA) firm to redo the work, and we will use it to determine whether any of the 35,000 participants in the National Steel plans received less than the benefits to which they were entitled.

If anyone's benefits were wrongly reduced, their benefits will be corrected and they will be repaid with interest – and an apology.

We also began reviews of both our actions and those of our contractors. We are holding people accountable and taking other actions where appropriate.

Ensuring PBGC's Integrity in the Future

Even if no one's benefits turn out to have been wrongly determined, PBGC can and will improve the way we do our job, to provide comfort to future retirees. We have begun a range of activities to do so. Among them:

- PBGC is changing both plan asset evaluations and how they are reviewed. We have established the position of auditor technical reviewer in each of the Benefits Administration and Payment Department's (BAPD) Trusteeship Processing Divisions (TPDs). This senior auditor will be responsible for reviewing all of the audits in the division, to ensure that policies, procedures, and quality standards are met. In addition, we have strengthened the authority and responsibility of the Audit Manager to enforce existing BAPD auditing standards and to ensure consistency and standardization among the TPD auditors. We are also developing more systematic and thorough training for those reviewers.

- PBGC is raising the requirements of our Evaluation/Review services contracts to improve the quality of work in the plan asset area. The new contractors will both redo the past work and be responsible for new plan asset evaluations. We have changed the way in which we monitor these contracts and will continue to do so in the future.

- Several months ago, I tasked PBGC's Deputy Director for Operations (DDO) to conduct a top to bottom strategic review of BAPD's organization, policies and procedures, with the goal of deciding what additional changes are necessary. To facilitate that review, we are placing BAPD directly under the DDO, and transferring many of his other responsibilities to others within PBGC.

Did these Mistakes Change Anyone's PBGC Benefits?

There is no question that the asset audit work done in 2003-2004 was bad work. But that does not necessarily mean that anyone's benefits were reduced as a result.

We appreciate that the OIG report cautioned readers not to jump to conclusions about any effect on benefits. We think it is important to explain why.

First, ***for most people, the amount of plan assets received by PBGC has no effect at all on the benefits they receive from PBGC.*** The amount of plan assets will not affect anyone who is already receiving their full benefit.

Second, the amount of plan assets does not affect whether PBGC may pay shutdown benefits. PBGC can pay these benefits only in certain circumstances, which do not apply in this case.

Third, although the original work was not done to appropriate standards and lacked the appropriate documentation, PBGC may nonetheless still have the correct amount and allocation of plan assets. PBGC has contracted with a public accountant (CPA) firm for a detailed re-calculation of National Steel's plan assets; this work is currently underway and should be done sometime this summer.

Who Might Get a Higher Benefit? The retirees that have the best chance of being helped if we find that there are additional assets are those who retired or could have retired three years before plan termination (that is, they retired or could have retired by December 6, 1999) *and* whose plan benefit is above the amount that PBGC can guarantee. Even for those, the law (a) excludes any benefit increases in the 5 years before termination and (b) requires PBGC to pro-rate benefits based on the amount of funding in the plan. When a plan is seriously underfunded, it often turns out that the PBGC guaranteed level is higher than the pro-rated benefit, so we pay the PBGC guaranteed amount. In those cases, plan assets won't affect benefits. (For an explanation of how this works, see Appendix II.)

Reporting to National Steel Pensioners

Once we know if anyone was affected and, if so, by how much, I will meet personally with the National Steel pensioners in Minnesota, to explain the past actions and what PBGC is doing now to correct them. I plan to do so this summer.

How PBGC is Implementing OIG Recommendations

Your report makes a dozen recommendations, both to correct the 2003-2004 asset audit and to put in place auditors and audit procedures to ensure that its failings will be a thing of the past. ***PBGC is implementing or will implement every one of them.*** Appendix I summarizes your recommendations and how we will do so.

None of us yet knows whether anyone's benefit was wrongly reduced; we will find out and we will repay any shortfalls with interest and an apology. But whether anyone was shortchanged or not, our goal is to restore and ensure the integrity of the PBGC and the security of the millions whose pensions we stand behind.

We are grateful for your work and look forward to the better PBGC and greater security among our retirees that will result from it.

Appendix I: Specific Responses to Individual OIG Recommendations

PBGC has begun implementing or will implement each of your specific recommendations.

Correcting the National Steel Plan Asset Audit

OIG Recommendation 1

Formally withdraw the National Steel plan asset audit report and post notice of withdrawal on PBGC's external website. The notice is to remain on the website until the new National Steel plan asset report is completed and accepted by PBGC with a statement in the new report regarding the withdrawal of the prior asset audit report.

PBGC Response

Management will withdraw the current National Steel Plan Asset Audit report and post a notice on the PBGC website to let participants know that the asset audit is being redone. The notice will also state that the existing benefit determinations remain in effect and should be relied on unless or until they are changed.

OIG Recommendation 2

Ensure that the CPA's ongoing re-evaluation addresses each of the omitted procedures, including but not limited to accrual of interest on fixed income and cash and cash equivalents; independent validation of the custodian's valuation for hard-to-value and nontraditional assets; verification of transfers and unusual transactions; confirmation of payables; and review of internal controls.

PBGC Response

Management has directed the CPA firm to include the OIG's recommendation into their testing. As your report notes, the CPA firm will face difficulties, in part, due to the passage of time. To the extent that testing can be performed, the independent CPA firm assigned to National Steel will test the areas cited in the recommendation. Where testing cannot be performed (e.g., a review of internal controls and confirmation testing), the independent CPA firm will design alternative testing procedures or increase the scope of their testing.

OIG Recommendation 3

Ensure that the CPA's ongoing re-evaluation includes steps to contact likely sources, such as insurance companies, investment managers, accountants, and plan administrators for the purpose of identifying assets not listed on custodian bank statements. To the degree that such contacts are no longer possible (e.g., the asset manager is no longer in business), develop and perform alternative procedures to provide assurance that all assets have been properly identified, collected, and allocated to the National Steel plans.

PBGC Response

Management has directed the CPA firm to include the OIG's recommendation in their testing. Management has reviewed and approved the CPA firm's audit program that includes the required steps or alternative testing to ensure that all assets for the Plans have been properly identified, collected, and allocated to the National Steel plans.

OIG Recommendation 4

In the event that the CPA is unable to perform the procedures that were required at the time the plan asset audit was issued, ensure that the CPA's ongoing re-evaluation includes alternative steps to identify potential fiduciary breaches, conflicts of interest, and fraud.

PBGC Response

Management has directed the CPA firm to include the OIG's recommendation in their testing. Management is reviewing the CPA firm's audit program's alternative procedures to identify potential fiduciary breaches, conflicts of interest, and fraud.

OIG Recommendation 5

Ensure that the CPA's ongoing re-evaluation includes validation of the allocation percentages used to distribute commingled assets among the various plans. Additionally, ensure that assets are distributed consistently with the type of ownership. That is, for items such as insurance contracts, annuity contracts, and real estate that are not owned in common with the other National Steel plans, allocate the value to the plan that owns the asset.

PBGC Response

Management has directed the CPA firm to include the OIG's recommendation to ensure that specific issues identified are taken into account during their testing. Testing the allocation of assets for the National Steel Plans is a central task of the reevaluation we are asking of the CPA firm to perform. Management has reviewed and approved the specific audit programs of the CPA firm, including alternative procedures for testing of the allocation of assets among the National Steel Plans.

Improving Future Plan Asset Audits

OIG Recommendation 6

Use the results of PBGC's review of plan asset audits completed over the last two years to enhance training and modify guidance as warranted.

PBGC Response

Management will incorporate results of the two year look-back testing into the plan asset audit course that is scheduled to be developed during FY2011. Management will also provide additional guidance to auditors through updated procedures or references in the Auditor's Technical Manual where appropriate.

OIG Recommendation 7

Ensure that technical monitors are aware of their responsibility to review the work performed by contract auditors, including an assessment of whether the conclusions in the audit report are supported by the results of audit testing, a comparison of the work performed by the contract auditors to the work mandated in PBGC protocols, and review and resolution of material variances disclosed during the course of an audit.

PBGC Response

Management held a two-day workshop with the Auditor Technical Reviewers (technical monitors) on January 12th and January 31st to discuss their responsibilities in the review and evaluation of contractor audits. The Contracting Officer's Technical Representative will meet with the Auditor Technical Reviewer and a representative from the Trusteeship Processing Division Management Team, where appropriate, to re-emphasize the responsibilities each time a new asset evaluation is undertaken.

OIG Recommendation 8

Within BAPD, develop a department-level "robust" quality assurance program aimed at ensuring plan asset valuations are performed in accordance with applicable procedures and standards.

PBGC Response

PBGC is in the process of developing a department-level, robust quality assurance program aimed at ensuring plan asset valuations are performed in accordance with applicable procedures and standards. The program will consist of several parts including (a) appropriate work reviews, (b) improved and targeted training, (c) improved procedures, (d) improved lessons learned and related communications and (e) a formal assessment of process adherence through a Product and Process Quality Assurance Program. A contract award for Product and Process Quality Assurance has already been made.

Additionally, PBGC is undertaking a strategic review of BAPD, including its processes, personnel, and organization. This review is being led by the Deputy Director for Operations, assisted by PBGC staff as well as outside experts. The goals of this review are to assess and, as appropriate, refine BAPD's operational strategy; align the structure, systems and processes; and improve customer service (quality of products, services and timeliness) and accountability. The procurement for this strategic review is underway.

OIG Recommendation 9

Enhance and formalize training efforts for auditors to better guide them on appropriate planning, risk assessment, and scope of procedures to be performed as part of the audit program. Further, enhanced training on illiquid investments, fiduciary breaches, and other special situations should be provided.

PBGC Response

Management will re-look at the current auditor curriculum for the BAPD auditors to address the items outlined in the OIG's recommendation. Where appropriate, management will seek outside consultants in developing training for these items.

OIG Recommendation 10

Develop and maintain a process to share "lessons learned" and best practices in a formal and consistent manner to ensure that all appropriate personnel become aware of best practices and are able to use them in future audits.

PBGC Response

Management has begun to use the Auditor's Quarterly meetings and monthly Auditor Technical Reviewer meetings to formalize the lessons learned and best practices. Specific meeting notes or topics will be included in the Auditor's Technical Manual or Portal for future reference.

OIG Recommendation 11

Expand the current written procedures to include procedures and a checklist of factual and legal items for identifying all available assets, including those not custodied with the primary custodian bank; for example: insurable assets; intellectual property; accounts held by asset custodians elsewhere (e.g., at a prime brokerage firm); and potential plan assets that may be less obvious than other plan assets.

PBGC Response

Management will update its procedures manual and applicable audit programs to include the items noted in the OIG's recommendation.

OIG Recommendation 12

Develop and implement specific audit procedures to ensure the integrity and fairness of allocation percentages used in situations where plan assets have been commingled.

PBGC Response

Management is working to update its procedures manual and train staff on how to audit plans where an allocation of assets is needed.

Appendix II – How & When Pension Plan Assets Affect PBGC Benefits

This appendix explains how the amount of assets in a terminated pension plan may affect the benefits of the plan participants.

For most people, the amount of plan assets received by PBGC has *no effect* on the benefits they receive from PBGC. This is because, under the law, assets only come into play when a participant's earned pension benefit would be *above* PBGC's guarantee limits.

To determine the benefit that PBGC can pay, we must first determine the benefit that each participant is entitled to at the Date of Plan Termination (or DOPT) under the provisions of their pension plan. PBGC then determines how much of that plan benefit it may pay. First, we calculate the benefit that PBGC guarantees by applying the limits in the Employee Retirement Income Security Act (ERISA) and PBGC regulations. The guaranteed benefit is the amount that PBGC pays regardless of the assets in the pension plan.

For participants whose earned plan benefit *is* higher than what PBGC may guarantee, we calculate the portion of the earned benefit that the pension plan's assets would cover. If the portion of the benefit that would be covered by assets is greater, we pay that larger amount. When a plan is severely underfunded, the portion of earned benefit that the assets cover is often less than the PBGC guaranteed amount, so we pay the higher PBGC guaranteed amount.

To determine the benefit provided by the plan's assets, PBGC allocates the plan's assets, at the Date of Plan Termination, to six categories of benefits called priority categories (PCs). Here is a brief summary of the six priority categories:

PC1: Benefits from employees' voluntary contributions. Most plans have no PC1 benefits.

PC2: Benefits from employees' mandatory contributions (contributions required to participate in the plan or to receive certain benefits). Most plans have no or few PC2 benefits.

PC3: Benefits of participants who retired, or could have retired, at least three years before plan termination, Not all benefits are included in PC3: the benefits that are included in PC3 are those benefits to which the participant was entitled three years before the plan terminated, generally based on provisions of the plan in effect 5 years before the plan terminated. *This is the category of beneficiaries that is most likely to have a chance of a benefit improvement based on the allocation of plan assets.*

PC4: All other benefits (i.e., not in PC1-PC3) guaranteed by PBGC.

PC5: All other nonforfeitable (vested) benefits (not in PC1-PC4).

PC6: All other benefits under the plan (not in PC1-PC5).

PBGC distributes the total value of the plan's assets among the benefits, starting with PC1. If the assets cover all benefits in PC1, the remaining assets go to PC2, and so on until they run out. In the category in which they run out, PBGC divides the assets among the benefits under the Employee Retirement Income Security Act's rules (generally pro rata, except in PC5, which has special rules).

Usually the most important category for participants is PC3. Since most plans have few or no employee contributions, PC3 is often the first category to which assets are allocated. Also, benefits in PC3 – whether guaranteed or not – are paid ahead of other PBGC-guaranteed benefits, which are in PC4. Thus, it is possible for a participant to receive more than his guaranteed amount if assets allocated to PC3 provide a larger benefit.

Example: Here's an example of how PC3 works:

Plan ABC has $10 million of assets at its Date of Plan Termination.

There are no benefits in PC1 or PC2. Benefits in PC3 have a value of $20 million. Therefore, the assets are allocated first to PC3. Assets cover 50% of the benefits in PC3.

A participant in the ABC plan has a monthly benefit of $4000 as of the Date of Plan Termination. However, his benefit is limited by the PBGC maximum guarantee – his guaranteed benefit is $3000/month.

Suppose that this participant retired six years before plan termination so that his PC3 benefit is the same as the benefit as of the Date of Plan Termination, or $4000. The benefit amount that the assets provide is 50% of his PC3 benefit, or 50% of $4000. So this participant's "funded PC3 benefit" equals $2000/month. In this case, the assets did not provide a greater benefit and so PBGC will pay the guaranteed benefit of $3000.

If, however, the plan assets were $20 million, they would provide 100% of PC3 benefits so the participant would receive his full PC3 benefit of $4,000, which is greater than his $3,000 guaranteed benefit.

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

The deaf or hard of hearing, dial FRS (800) 877-8339
and give the Hotline number to the relay operator.

Web:
http://oig.pbgc.gov/investigation/details.html

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