109242

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Examination Of Financial Statements Of The Pension Benefit Guaranty Corporation For The Fiscal Year Ended September 30, 1977

Because of various procedural and accounting problems, and material uncertainties in the collection of receivables, GAO disclaims an opinion on whether the financial statements fairly present the financial position of the Corporation at September 30, 1977, and the results of its operations and changes in financial position for the 12-month period then ended.

109242

HRD-79-44
MAY 3, 1979

005132

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164292

To the President of the Senate and the
Speaker of the House of Representatives

Pursuant to the Government Corporation Control Act (31 U.S.C. 850), we have examined the financial statements of the Pension Benefit Guaranty Corporation for the fiscal year ended September 30, 1977.

The Corporation was established by title IV of the Employee Retirement Income Security Act, enacted September 2, 1974 (29 U.S.C. 1302). The Corporation administers the insurance programs established by the act to guarantee that certain benefits are paid to participants of defined benefit pension plans, if these plans terminate without sufficient assets to provide benefits guaranteed under the act.

SCOPE OF EXAMINATION

Our examination of the accompanying Combined Statement of Financial Condition of the Pension Benefit Guaranty Corporation as of September 30, 1977, and the related Combined Statement of Operations and Changes in Equity (Deficiency in Assets), and Changes in Financial Position for the year ended September 30, 1977, was made in accordance with the Comptroller General's standards for auditing financial transactions, accounts, and reports of governmental activities. These standards include generally accepted auditing standards. Our examination included such tests of the accounting records and such other auditing procedures as we considered necessary.

Because of the materiality of accounting and estimating problems and uncertainties concerning several major account balances for the single employer program, we did not extend, except for our sample review of premium payment activity, audit tests and procedures to the financial transactions of the multiemployer program. Further, we did not audit financial data furnished by interim custodians, plan sponsors or administrators, and other third parties.

Price Waterhouse & Co. examined the portfolio transactions of the Corporation's trust funds maintained at State Street Bank and Trust Company, Boston, Massachusetts, custodian of the Corporation, for the 19-month period ended December 31, 1977. Although no material deficiencies were discovered, Price Waterhouse did not issue an opinion because the trial balance, provided by the Corporation, did not purport to present the financial statements in accordance with generally accepted accounting principles. Due to the nature and extent of this examination, we did not audit this activity.

DISCLAIMER OF OPINION
ON FINANCIAL STATEMENTS

GAO could not verify
~~We can~~not ~~express an opinion~~ that the Corporation's financial statements present fairly the financial position of the Corporation at September 30, 1977, and the results of its operations and changes in financial position for the 12-month period then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. We did not audit the comparative financial statements of the Corporation for the 15-month period ended September 30, 1976, and accordingly are not rendering an opinion on them.

The disclaimer of an opinion on the financial statements is required because of various procedural and accounting problems and material uncertainties in the collection of receivables. The specific reasons for the disclaimer are discussed under the following captions which correspond to individual asset, liability, equity, and income and expense account balances the Corporation reported in its fiscal year 1977 financial statements which were issued during January 1979.

INVESTMENTS

The Corporation's investment portfolio of $92 million as of September 30, 1977, for the single employer program included U.S. Government securities, corporate stocks and bonds, insurance contracts, and other assets. The accounting function for investments associated with 50 of 150 plans in trusteeship at September 30, 1977, 1/ was performed by commercial banks or insurance companies, as interim custodians. By agreement with the custodians, the Corporation is supposed to receive monthly financial reports from them.

The custodians reported about $11 million of the investments to the Corporation. We reviewed the Corporation's files of 18 interim custodians which, although not verified by the Corporation, served as support for about $10 million of the reported investments. These files contained financial reports which in some cases were not (1) prepared in accordance with generally accepted accounting principles or (2) provided in a timely manner for use in statement preparation. In the latter situation, the Corporation used other reports or documents showing investment data at times earlier than September 30, 1977. Thus, not all assets were valued as of September 30, 1977.

AMOUNTS DUE FROM EMPLOYERS

Plan sponsors (employers) of terminated pension plans, which do not have sufficient assets to pay benefits guaranteed to participants, are liable to the Corporation for any insufficiency. This liability is limited to 30 percent of the company's statutory net worth or the plan asset insufficiency, whichever is less. The Corporation estimated a liability receivable from employers of $35.4 million as of September 30, 1977,

The collectibility of this liability, however, is questionable. because (1) the actual amount owed in most cases is still uncertain, (2) the validity of the overall estimate is questionable due to deficiencies in the Corporation's estimating methodology, (3) the allowance for uncollectibles and other valuation allowances lack historical basis, (4) some employers of terminated plans are either in bankruptcy, in liquidation, or out of business, and (5) the

1/The Corporation, as trustee, has taken over responsibility from the plan administrators for financial aspects of the plans such as receipts, disbursements, and investment of pension funds.

Corporation's ability to assess and collect employer liability, under certain circumstances, has been challenged in the courts. The ultimate outcome of the court cases cannot be predicted at this time. (See notes 5 and 7 to the combined financial statements.)

ASSETS OF TERMINATED PLANS NOT IN TRUSTEESHIP

Until insufficient terminated plans are trusteed, plan administrators maintain records and provide financial reports or accounting data to the Corporation on request. The Corporation, however, did not confirm the reasonableness of the data. Even when plan administrators were requested to provide data, some did not respond and the Corporation had to estimate. Financial data were obtained in fiscal year 1977 only from administrators whose plan assets exceeded $100,000 at or near the date of plan termination.

For plans whose assets were less than $100,000, the Corporation used the asset valuation as of dates of termination and adjusted this value by estimating benefit payments, administrative expenses, investment income, and gains or losses since dates of termination.

The Corporation extensively used unsubstantiated financial data from sources outside the Corporation's control, as well as unsupported estimates in lieu of data that were not provided to or requested by the Corporation. The estimates for benefit payments, for example, did not consider that previously deferred beneficiaries could have become eligible to receive benefits. Accordingly, we cannot substantiate the reasonableness of the $46.8 million reported in the financial statements as of September 30, 1977.

PRESENT VALUE OF FUTURE BENEFITS FOR TERMINATED PLANS--SINGLE EMPLOYER PROGRAM

The Corporation's estimated liability for future benefits as of September 30, 1977, was $209 million. This amount was based on (1) estimates by plan administrators, private actuaries, or the Corporation and (2) actual benefits payable in those cases where the Corporation had all essential data for making the final benefit determination.

it is not certain

We do not know whether the reported amount presents fairly the estimated liability for future benefits. Its validity is questionable primarily because (1) 88 percent of the amount is estimated, (2) any differences that could arise between plan administrators' estimates and the Corporation's eventual determination could be significant, and (3) the amount includes adjustments for the participant aging factor and changes in rate of investment return for 29 plans which were deleted from the Corporation's universe of terminated plans either because they were restored to an active status or because the insufficiency was made up.

Also, no analysis for actuarial adjustments was made in about 20 percent of the universe of terminated plans. The lack of actuarial adjustments resulted from the assumption that the plans had dates of termination so near September 30, 1977, that adjustments, if made, would have only a minimal effect on the account. Our analysis showed, however, that nearly half of these plans had dates of termination in the prior 2 fiscal years.

In addition, when the Corporation lacked the necessary data to compute the liability, in some cases an estimate was made based on an assumed number of participants and assumed average benefits per participant. In other cases, it was estimated that future benefits would not be greater than plan assets even though the extent of the benefit liability was unknown. This assumption could materially misstate the Corporation's liability.

ESTIMATED NET CLAIMS FOR PENDING TERMINATIONS

The Corporation estimated about $51 million in pending terminations as of September 30, 1977. However, the full extent of its liability for future benefits associated with incurred but unreported plan terminations and unreported pending terminations is not known. Since the Corporation is relatively new, only limited historical experience is available.

UNEARNED PREMIUM INCOME

The actual amount of unearned premiums, reported as $7.6 million for fiscal year 1977, cannot be validated. The account included some amounts representing underpayments from prior accounting periods which were received in 1977. All these amounts were earned as of September 30, 1977. Nevertheless, a certain percentage was allocated as unearned in 1977. In addition, the Corporation allocated premium overpayments even though the entire amount was unearned and ignored premium underpayments due in 1977 but not yet received. We cannot place a dollar value on these items.

Because of these problems, we cannot state that the amount of unearned premium income reported in the financial statements was fairly presented as of September 30, 1977.

BENEFITS PAID

A significant amount of benefits paid was estimated by the Corporation or based on unsubstantiated financial reports provided by plan administrators or interim custodians. Consequently, we were not able to substantiate about $8.5 million of the $13 million in reported total payments.

We cannot state that this account was fairly presented for the period ended September 30, 1977, because of (1) the large amount of estimates and unsubstantiated data and (2) the fact that the Corporation neither decreased its benefit payment estimate for certain plans deleted from its universe nor increased the benefit payment estimate for other plans added to its universe.

AMOUNTS NOT REFLECTED IN FINANCIAL STATEMENTS

A Corporation study identified many premium billing and collection system weaknesses, ranging from duplicate premium filings or no filings to computer entry errors. Because of these weaknesses, the Corporation had not billed plan administrators for premium underpayments and late payment penalty and interest charges, or refunded a large amount of premium overpayments. Accordingly, the amounts are not included on the financial statements. Efforts are being made to correct these problems, but the exact dollar amount collectible or refundable is unknown.

Our analysis indicates the amount could be substantial. We sampled 195 single employer and multiemployer plans with

1,000 or more participants to determine the overall materiality of the omissions as of September 30, 1977. Our sample results show that unrecorded receivables for uncollected premiums and late payment charges could be about $2.9 million; liabilities for premium overpayments, about $1.8 million; accrued late payment revenue, about $1.8 million; and premium income could be overstated by about $0.7 million.

EQUITY (DEFICIENCY IN ASSETS)

The Corporation reported a deficit of $95.3 million as of September 30, 1977, a $54.3 million increase over the previous fiscal year for the single employer program. Because of various reasons cited in the preceding paragraphs, we cannot state that the financial statements present fairly the deficit at September 30, 1977.

CORPORATION'S COMMENTS

In a letter dated March 16, 1979, the Executive Director of the Corporation indicated only slight differences with the contents of this report. He did not comment on the differences, rather, he discussed the development of the 1977 financial statements within the context of a new evolving Corporation which can easily encounter various financial management and administrative problems as it matures. He described the corrective action the Corporation is taking to improve its overall financial management system. (See app. I.)

\- - - -

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretaries of Commerce, Labor, and the Treasury; and the Executive Director, Pension Benefit Guaranty Corporation.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act of 1974
PBGC	Pension Benefit Guaranty Corporation

 SCHEDULE 1

COMBINED STATEMENT OF FINANCIAL CONDITION

PENSION BENEFIT GUARANTY CORPORATION

ASSETS	Single-employer fund September 30, 1977	1976	Multiemployer fund September 30, 1977	1976	Combined September 30, 1977	1976
	(In thousands)					
Investments, at approximate market-Notes 1 and 3:						
U.S. Government securities	$60,556	$47,016	$12,484	$10,491	$73,040	$57,507
Common stocks and other equity securities	18,877	10,347	87	-	18,964	10,347
Corporate bonds and commercial paper	4,933	4,006	387	-	5,320	4,006
Insurance contracts	7,243	7,519	-	-	7,243	7,519
Other, including accrued investment income	395	449	1,652	94	2,047	543
Total investments	92,004	69,337	14,610	10,585	106,614	79,922
Cash	869	870	138	49	1,007	919
Amounts due from employers-Notes 1, 5 and 7:						
By agreement	44	47	-	-	44	47
Estimated future recoveries on terminated plans	35,413	29,884	5,000	-	40,413	29,884
	35,457	29,931	5,000	-	40,457	29,931
Assets of terminated plans, not in trusteeship-Note 1	46,797	26,454	697	-	47,494	26,454
Furniture and equipment, net-Note 1	664	667	59	42	723	709
	$175,791	$127,259	$20,504	$10,676	$196,295	$137,935

LIABILITIES	Single-employer 1977	1976	Multiemployer 1977	1976	Combined 1977	1976
Reserve for guaranteed benefits-Notes 1 and 4:						
Present value of future benefits for terminated plans	$209,000	$144,000	$18,864	$ -	$227,864	$144,000
Estimated net claims for pending terminations	51,000	15,000	-	-	51,000	15,000
	260,000	159,000	18,864	-	278,864	159,000
Unearned premium income-Notes 1 and 2	7,600	8,000	1,600	1,700	9,200	9,700
Accounts payable	912	787	-	-	912	787
Accrued expenses and other liabilities-Note 6	2,582	467	40	-	2,622	467
	271,094	168,254	20,504	1,700	291,598	169,954
EQUITY (DEFICIENCY IN ASSETS)-Note 2:						
Accumulated increase (decrease) from operations	(95,303)	(40,995)	(12,512)	8,976	(107,815)	(32,019)
Amount offset in liabilities reducing the present value of future benefits for terminated plans due to statutory coverage limitation	-	-	12,512	-	12,512	-
	(95,303)	(40,995)	0	8,976	(95,303)	(32,019)
COMMITMENTS AND CONTINGENCIES-Note 7	-	-	-	-	-	-
	$175,791	$127,259	$20,504	$10,676	$196,295	$137,935

Certain amounts have been reclassified in 1976 for comparative purposes.

The notes on pages 4 through 12 are an integral part of this statement.

SCHEDULE 2

COMBINED STATEMENT OF OPERATIONS AND CHANGES IN EQUITY (DEFICIENCY IN ASSETS)

PENSION BENEFIT GUARANTY CORPORATION

	Single-employer fund		Multiemployer fund		Combined	
	Year ended	Fifteen months ended	Year ended	Fifteen months ended	Year ended	Fifteen months ended
	September 30,		September 30,		September 30,	
	1977	1976	1977	1976	1977	1976
	(In thousands)					
REVENUES:						
Premium income-Notes 1 and 2	$25,062	$29,664	$ 4,172	$5,432	$29,234	$35,087
Investment income-Notes 1 and 3	5,666	7,034	1,891	875	7,557	7,909
Other	36	10	4	1	40	11
	30,764	36,708	6,067	6,299	36,831	43,007
PENSION BENEFITS AND EXPENSES:						
Net addition to reserve for guaranteed benefits-Notes 1 and 4	60,000	42,600	19,476	-	79,476	42,600
Benefits paid-Note 1	13,024	9,500	6,761	-	19,785	9,500
Administrative expenses	12,048	9,867	1,318	626	13,366	10,493
	85,072	61,967	27,555	626	112,627	62,593
NET INCOME (LOSS)	(54,308)	(25,259)	(21,488)	5,673	(75,796)	(19,586)
Equity (deficiency in assets) at beginning of period	(40,995)	(15,736)	8,976	3,303	(32,019)	(12,433)
Statutory limitation of guaranteed benefits offset against the present value of future benefits payable-Note 2	-	-	12,512	-	12,512	-
EQUITY (DEFICIENCY IN ASSETS) AT END OF PERIOD	$(95,303)	$(40,995)	$ -	$8,976	$(95,303)	$(32,019)

Certain amounts have been reclassified in 1976 for comparative purposes.

The notes on pages 4 through 10 are an integral part of this statement.

SCHEDULE 2

COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

PENSION BENEFIT GUARANTY CORPORATION

SOURCES OF FUNDS	Single-employer fund Year ended September 30, 1977	Single-employer fund Fifteen months ended September 30, 1976	Multiemployer fund Year ended September 30, 1977	Multiemployer fund Fifteen months ended September 30, 1976	Combined Year ended September 30, 1977	Combined Fifteen months ended September 30, 1976
	(In thousands)					
From operations:						
Net income (loss)	$(54,308)	$(25,259)	$(21,488)	$5,673	$(75,796)	$(19,586)
Charges to operations not affecting cash and investments:						
Depreciation	83	56	9	4	92	60
Reserve for guaranteed benefits:						
Total addition to reserve	101,000	100,700	31,376	-	132,376	100,700
Less assets available from newly terminated plans	(41,000)	(58,100)	(11,900)	-	(52,900)	(58,100)
	60,000	42,600	19,476	-	79,476	42,600
Decrease in unearned premiums	(400)	(3,000)	(100)	(400)	(500)	(3,400)
Total provided by (used for) operations	5,375	14,397	(2,103)	5,277	3,272	19,674
Assets available from newly terminated plans	41,000	58,100	11,900	-	52,900	58,100
(Increase) in assets of terminated plans	(20,343)	(5,512)	(697)	-	(21,040)	(5,512)
(Increase) in estimated future recoveries of employer liability	(5,529)	(25,730)	(5,000)	-	(10,529)	(25,730)
	15,128	26,858	6,203	-	21,331	26,858
Total sources	20,503	41,255	4,100	5,277	24,603	46,532
Uses of funds:						
Additions to furniture and equipment	80	651	26	44	106	695
(Decrease) in other assets	(3)	(2)	-	-	(3)	(2)
(Increase) decrease in other liabilities	(2,240)	(442)	(40)	111	(2,280)	(331)
TOTAL USES (ADDITIONAL SOURCES)	(2,163)	207	(14)	155	(2,177)	362
INCREASE IN CASH AND INVESTMENTS	$ 22,666	$ 41,048	$ 4,114	$5,122	$ 26,780	$ 46,170

Certain amounts have been reclassified for comparative purposes.

SCHEDULE 3

NOTES TO COMBINED FINANCIAL STATEMENTS
PENSION BENEFIT GUARANTY CORPORATION
September 30, 1977

Note 1 - ORGANIZATION AND ACCOUNTING POLICIES

The Pension Benefit Guaranty Corporation (PBGC) commenced operations on September 2, 1974, in accordance with the provisions of Title IV of the Employee Retirement Income Security Act of 1974 (ERISA or the Act), as a self-sustaining Government Corporation subject to the provisions of the Government Corporation Control Act. Commensurate with its statutory mandate, PBGC is contingently liable for the payment of pension benefits, within the guarantee limits of ERISA, for all covered private defined benefit pension plans to the extent that plan assets are insufficient to meet benefit obligations. This liability (net claim) arises upon plan termination, and is valued based on the plan asset insufficiency less amounts estimated to be recoverable from employers, as of the termination date.

BASIS OF FINANCIAL STATEMENTS: The Combined Financial Statements include the accountability for defined benefit pension plans which are expected to result in trusteeship by the Corporation, even though such plans have not been placed in trusteeship at the end of the fiscal year. The statements also include estimated financial data relating to certain plans for which actual data was not available to the Corporation at the end of the fiscal year due to the sequential nature of processing a terminated pension plan and the associated flow of information from plan administrators and trustees of terminated plans. Changes in these estimates are reflected in the financial statements when actual data becomes available. Management does not believe the use of these estimating methods will have a significant impact on either the current or future financial position or results of operations of the Corporation.

FUND ACCOUNTING: PBGC maintains both a revolving fund and trust fund for each of its basic benefit programs (single employer and multiemployer). Administrative expenses are charged and premium collections credited to the revolving funds. Assets of terminated plans and employer liability collectible amounts are included in trust funds and those funds are credited for the present value of future benefits guaranteed by PBGC. The trust funds also include the reserve for pending terminations as more fully described in Note 4.

Gains or losses resulting from plan operations subsequent to termination are included in the trust fund accounts. These amounts are subsequently transferred to the revolving fund on a periodic basis, after recognizing benefit payments made directly from the revolving fund. Benefit payments presented in the Combined Statement of Operations include both payments made directly by PBGC and payments made by third-party trustees. The Combined Financial Statements also include transactions since the date of termination for plans identified for potential or actual trusteeship during the year.

The single employer revolving and trust funds and the multiemployer revolving and trust funds have been combined for presentation in the financial statements. The single employer and multiemployer funds are separate entities and gains from one fund cannot be used to offset losses from another fund.

ASSET VALUATION: Assets assumed by PBGC from plan terminations are valued at fair market value except that insurance contracts are valued in accordance with PBGC interim working rules designed to recognize the value of benefits which can be provided. Any appreciation or diminution in value, whether realized or unrealized, is included in investment income in the accompanying Combined Statement of Operations.

The value of plan assets not in trusteeship has been estimated by analysis of information from the larger terminated plans being processed. The results of this analysis were used to project the asset values relating to remaining insufficiently funded plans.

An employer is required by ERISA to make employer liability payments to PBGC whenever a plan under its sponsorship terminates and the value of plan liabilities guaranteed by PBGC exceeds the value of plan assets, as of the date of termination. The amount of this liability, however, is limited to 30 percent of the employer's statutory net worth or the plan asset insufficiency, whichever is less. For terminated insufficient plans, amounts estimated to be recoverable from employers have been recognized as assets as of the date of termination.

DEPRECIATION: Depreciation of furniture and equipment is provided on the straight-line basis over the estimated useful lives of the assets ranging from 5 to 10 years. Leasehold improvements (which amounts are insignificant) have been charged to operations as incurred.

RESERVE FOR PENDING TERMINATIONS: The reserve for pending terminations represents the estimated net claims resulting from a combination of (1) plans which were under active review at the end of the year which the Corporation expects to result in termination ($39,000,000) and (2) anticipated terminations based on experience during the period from inception ($12,000,000).

PREMIUM INCOME: Through 1977, annual premiums are payable from each plan within 30 days following the commencement of its plan year. Revenue is recognized as earned during the year. Plans with years beginning on or after January 1, 1978, will be required to pay premiums within 7 months after the end of the previous plan year. These premiums will also be recognized in revenues as the income is earned. ERISA provides that the Corporation shall not cease to guarantee basic benefits on account of the failure of a plan administrator to pay any premium when due. Management does not believe non-payment of premiums to be significant in comparison to the total plan universe. The Corporation, as provided by ERISA, is authorized to assess a late payment charge of not more than 100 percent of the premium payment which was not timely paid unless the Corporation grants a waiver based upon a showing of substantial hardship by a plan administrator. In addition, interest is chargeable for underpayment, nonpayment, or late payment of premiums. Management does not believe these amounts to be significant in relation to the total premiums collected by the Corporation.

Note 2 - FINANCING

The Corporation's operations are financed through premiums collected from ongoing covered plans, investment income, assets acquired from terminated plans, and the collection of employer liability payments due under the Act. As of September 30, 1977, the annual premiums were one dollar per participant for single employer plans, and fifty cents per participant in multiemployer plans.

PBGC programs are required by ERISA to be self-financing. PBGC may borrow up to $100 million from the U.S. Treasury to finance its operations. No debt was outstanding in connection with this borrowing authority during 1977 or 1976 and no use of this borrowing authority is contemplated. The Act provides under Title IV that the U.S. Government is not liable for any obligation or liability incurred by the Corporation.

The deficiency in assets reported in the accompanying financial statements for single employer plans is expected to be financed by future revenues. Public Law 95-214, enacted December 19, 1977, increased the premium for single employer plans to $2.60 per participant for all plan years beginning on or after January 1, 1978. Based on the current projection of future claims, this premium, plus investment income, is expected to fully finance the deficiency in assets in the single employer basic benefits program within approximately ten years, and fully fund claims as incurred.

PBGC is currently paying benefits to participants of four terminated multiemployer plans granted discretionary guarantees. If payments are continued at present levels, the present value of future benefits would exceed existing available assets by $12.5 million as of September 30, 1977. These benefits may have to be reduced in the future if the payment of benefits guaranteed under those plans would jeopardize the ability of the Corporation to pay benefits under multiemployer plans that terminate under a future mandatory guarantee program, or if the funds available for discretionary payments are exhausted. During the period of discretionary coverage of multiemployer plan terminations which was extended to June 30, 1979 by P.L. 95-214 referred to above, the Corporation is statutorily prevented from borrowing funds or increasing the premium to finance this coverage. Therefore, no deficiency in assets has been reported for multiemployer plans due to these statutory limitations and PBGC's limited commitment to provide benefits.

Pursuant to P.L. 95-214, PBGC is mandated to develop alternative courses of action for changes in the multiemployer program by July 1, 1978, to prevent and/or finance the substantial deficits anticipated in this program when coverage becomes mandatory.

Note 3 - INVESTMENT POLICY

Premium receipts are placed in the appropriate revolving fund and PBGC is required to invest such funds, in excess of current needs, in securities issued or guaranteed by the United States Government. Trust fund assets, which include both assets of terminated plans and employer liability payments, are now primarily invested in equity securities by independent money managers. Assets in the revolving funds are or will be used to pay guaranteed benefits, either directly or through the purchase of annuities. The trust funds will normally reimburse the revolving funds, as frequently as feasible but at least annually, for these expenditures on the following basis: assets will be transferred between the funds as needed so that the proportion of benefit payments financed by the trust funds, after reimbursement, is equivalent to the percentage of liabilities expected to be financed by assets of terminated plans and employer liability collections; and correspondingly, the unreimbursed portion of benefit payments made by the revolving funds is equivalent to the percentage of liabilities expected to be financed by premiums.

The amounts, at which investments are carried on the Combined Statement of Financial Condition (approximate market value) and the basis (value at date of PBGC obtaining control) of those assets are:

	1977		1976	
	Basis	Market value	Basis	Market value
	(In thousands)			
U.S. Government securities	$72,621	$73,040	$56,803	$57,507
Equity securities	19,918	18,964	10,206	10,347
Corporate bonds and paper	5,320	5,320	4,006	4,006
Insurance contracts	7,243	7,243	7,519	7,519
Other	2,047	2,047	543	543
	$107,149	$106,614	$79,077	$79,922

Investment income reported in the accompanying Combined Statement of Operations (which includes income since the date of termination for plans identified for potential or actual trusteeship during the year) consists of:

	Year Ended September 30, 1977	Fifteen Months Ended September 30, 1976
	(In thousands)	
Interest, dividends and other investment income	$9,308	$6,765
Realized and unrealized gains (losses)	(1,751)	1,144
	$7,557	$7,909

Note 4 - RESERVE FOR GUARANTEED BENEFITS

PBGC is required to guarantee certain basic benefits to participants when a covered plan terminates with insufficient assets to cover those benefits.

The present value of future benefits represents amounts, computed using actuarial methods as prescribed in PBGC regulations, of guaranteed benefits for plans which have terminated as of the end of the year, and for which PBGC has either assumed or is expected to assume trusteeship. Certain of these amounts have been calculated based on estimated data and a final actuarial determination has not been made by the Corporation due to the sequential nature of processing a terminated pension plan. Any changes in those estimates are reflected in the fiscal year when the benefits are actuarially determined by the Corporation. Management does not believe these estimating methods will have a significant impact on either the current or future financial position or results of operations of the Corporation. Pending terminations represent prospective net claims for cases which were under active review at the end of the current fiscal year and which are expected to become terminations in the subsequent year, and for anticipated terminations based on the experience of the Corporation. The reserve is adjusted subsequent to the date of termination to reflect benefits paid, passage of time, changes in actuarial assumptions and other factors. The net reserve relating to multiemployer plans represents the portion of benefits which could be funded by existing assets.

The addition to the reserve for guaranteed benefits included in the Combined Statement of Financial Condition and in the Combined Statement of Operations consists of:

	Single Employer Fund 1977	Single Employer Fund 1976	Multiemployer Fund 1977	Multiemployer Fund 1976
	(In thousands)			
Present value of liabilities assumed	$65,000	$86,200	$31,376	$ -
Provision for pending terminations	36,000	14,500	-	-
	101,000	100,700	31,376	-
Statutory limitation offset	-	-	(12,512)	-
Total increase in reserve included in Combined Statement of Financial Condition	101,000	100,700	18,864	-
Less plan assets assumed	(35,000)	(32,300)	(6,900)	-
Less estimated employer recoveries	(6,000)	(25,800)	(5,000)	-
Statutory limitation in expenses	-	-	12,512	-
	(41,000)	(58,100)	612	-
Total addition included in Combined Statement of Operations	$60,000	$42,600	$19,476	$ -

Note 5 - EMPLOYER LIABILITY RECOVERABLE

Amounts shown as recoverable from employers represent the total present value of anticipated settlements with employers for liability pursuant to the Act. These amounts are based in certain cases on estimated values of plan liabilities for guaranteed benefits, plan assets and/or employer net worth, if applicable, and are shown net of the estimated allowances for uncollectability. The amounts shown are based on the premise that employer liability provisions of the Act as interpreted by PBGC are legally enforceable. There have been several legal challenges to these provisions - see Note 7, "COMMITMENTS AND CONTINGENCIES."

Note 6 - ACCUMULATED LEAVE

Employers are permitted to accumulate certain unused annual leave which is payable when taken, upon severance of employment or retirement. Approximately $500,000 of the amount shown as accrued expenses represents accrued unused annual leave as of September 30, 1977.

With respect to accumulated unused sick leave, no accrual is necessary since employees do not have a formally vested interest in such leave until they reach retirement age and no amounts are paid unless sick leave is used.

Note 7 - COMMITMENTS AND CONTINGENCIES

Litigation which involves significant financial implications is currently pending. Although pleadings in some cases have included challenges to the constitutionality of employer liability, the question has not yet been formally addressed by a court. Final adverse rulings on the constitutional issues would restrict PBGC's ability to collect employer liability, and could result in an increase in the Corporation's deficiency in assets. In addition, two specific issues with possible financial impact are:

(1) Whether members of a controlled group of businesses are jointly and severally liable for the underfunding of a plan, based on the consolidated fair market value of the entire group. Final adverse rulings on this issue would restrict PBGC's ability to assess and collect liability from employers on the basis of the consolidated net worth of the controlled group and to assess employer liability against those members of a controlled group whose immediate employees did not participate in the terminated plan.

(2) The argument has been made that certain collectively-bargained plans, with a defined employer contribution rate, are not covered under Title IV of ERISA even though a given plan provides for a defined benefit. Final adverse rulings on this issue would impact the Corporation's liability for benefit obligations, entail the return of premiums paid to PBGC by these and similar plans, and prohibit future

premium collections in this regard. To date, several federal district courts and a U.S. Court of Appeals have ruled in favor of PBGC on this issue.

Although Management and counsel believe that the Corporation's position in these cases will be upheld, neither are in a position to predict the ultimate outcome of these matters.

PBGC leases its office facility under an agreement which expires in 1980. Minimum payments under the agreement are approximately $946,000 per year.

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

MAR 16 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

We are pleased to have this opportunity to comment on the proposed report of the General Accounting Office on the examination of the Pension Benefit Guaranty Corporation financial statements for the fiscal year ended September 30, 1977.

The report indicates that GAO is issuing a disclaimer of an opinion on the financial statements due to various procedural and accounting problems and material uncertainties in the collection of receivables. While the Corporation may differ slightly from some of the specific details of your report, we agree that there are some basic shortcomings in our present system, and we recognize the need for improvement. Rather than highlight these differences, we would like to put the 1977 financial statements in perspective within the evolution of PBGC and to explain briefly the high priority program which we have undertaken to make the required improvements.

Fiscal year 1977 represented the third fiscal year of PBGC's operations. During these three years, the Corporation has progressed considerably in its ability to measure and report its financial condition. For instance, in fiscal year 1975, we rendered financial statements on a modified cash basis for our revolving fund. For fiscal year 1976, we undertook major steps to convert to an accrual accounting basis and report on our trust fund activities. Our fiscal year 1977 statements reflect the Corporation's continuing efforts to improve its capability to capture information about our financial condition.

During our first three years, the Corporation received more than 19,000 notices of termination, as contrasted with the approximately 1,200 a year which Congress and

PBGC had been led to expect. As a result, we gave special priority to reviewing and approving the close-out of the more than 17,000 terminated sufficient plans so that those plans could distribute funds to their participants without delay. In hindsight, this management decision may have utilized resources that would have enhanced our ability to account for the approximately 450 plans which terminated prior to October 1, 1977, for which PBGC would be required to assume responsibility for guaranteed benefits because of the inadequacy of plan assets. However, the decision to devote PBGC manpower resources to sufficient plans expedited distributions to many thousands of participants, without interrupting the payment of benefits to participants in the insufficient terminated plans.

In the past 24 months we have significantly reduced the mammoth backlog resulting from the unexpectedly high initial volume of terminations. Since then, although sufficient plans still account for the bulk of our case load, a key case-processing priority has been to strengthen our capacity for the timely and accurate handling of insufficient plan terminations.

We are refining and integrating our computerized information-tracking systems, and developing approaches to gather better and more timely data. The productivity of our case-processing staff has been enhanced through training, more detailed procedural instructions, and more systematic and effective management controls. From the actuarial perspective, we have been able to build on our initial years' experience to develop improved methodologies for calculating, verifying and updating the Corporation's liabilities, particularly with respect to the total present value of outstanding benefit payment obligations. Furthermore, we are taking steps to reduce the termination processing time and thereby accelerating PBGC control of assets and benefit liabilities, a source of many of your comments.

In addition, we have undertaken as a major priority, a corporate-wide effort to develop an integrated financial management system that will help PBGC meet its responsibilities as a financial institution and achieve its program goals. A project of this magnitude, however, may take several years to complete. Therefore, we have developed a two-phase approach for this program.

As the first phase of this effort, PBGC has initiated a short-range program to make the interim improvements required to prepare satisfactory financial statements for fiscal year 1979. Because time and staff are limited, PBGC has contracted with a major accounting firm to help in achieving this objective. The contractor's recommendations are due in the near future. At that time a program will be instituted to implement the contractor's recommendations as well as continuing the effort to implement the improvements which have been initiated by the Corporation staff.

The second phase, the long-range objective, aims for a computer-based financial management system covering all relevant aspects of PBGC's operations. The outcome of the first phase will impact when PBGC begins moving toward the long-range objective and how long achieving that objective will take. However, we anticipate getting this program started later this year.

As in any major undertaking, the key to success is people. In this regard, we have been fortunate to have recently recruited a top-flight financial executive, Mr. Lawrence Maslan, to head up our financial operations. Larry brings more than twenty-five years of broad-range financial experience to the Corporation and will be more than able to provide us with the kind of leadership necessary in the financial area.

I want to assure you that the Corporation is concerned about the results of the audit and is placing the highest priority on taking the steps necessary to remedy the situation. However, it should be noted that the nature of PBGC's insurance program, like any insurance program, will require the use of estimates at any given point in time. Our efforts in this area will be directed toward minimizing the use of estimates, improving and refining the techniques used to make such estimates, and standardizing to the extent appropriate the procedures and methodology used in this regard.

On behalf of the Corporation I would like to take this opportunity to thank you and your staff for your understanding and assistance during the course of the engagement. We look forward to working closely with the General Accounting

Office as we develop and implement the improved systems and procedures which we all are awaiting.

If you wish to discuss these or any related matters, please feel free to contact me or Larry Maslan, Director of Financial Operations.

Sincerely,

Matt Lind

Matthew M. Lind
Executive Director

(20721)

Single copies of GAO reports are available free of charge. Requests (except by Members of Congress) for additional quantities should be accompanied by payment of $1.00 per copy.

Requests for single copies (without charge) should be sent to:

U.S. General Accounting Office
Distribution Section, Room 1518
441 G Street, NW.
Washington, DC 20548

Requests for multiple copies should be sent with checks or money orders to:

U.S. General Accounting Office
Distribution Section
P.O. Box 1020
Washington, DC 20013

Checks or money orders should be made payable to the U.S. General Accounting Office. NOTE: Stamps or Superintendent of Documents coupons will not be accepted.

PLEASE DO NOT SEND CASH

To expedite filling your order, use the report number and date in the lower right corner of the front cover.

GAO reports are now available on microfiche. If such copies will meet your needs, be sure to specify that you want microfiche copies.

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

U.S.MAIL

THIRD CLASS