



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-164292

August 29, 1994

The Honorable Robert B. Reich
Chairman, Board of Directors
Pension Benefit Guaranty Corporation

Dear Mr. Reich:

In May 1994, we issued our opinion on the fiscal year 1993 financial statements of the Single-Employer and Multiemployer Programs of the Pension Benefit Guaranty Corporation and our opinion on the Corporation's system of internal controls as of September 30, 1993. We also reported on the Corporation's compliance with applicable laws and regulations for the year ended September 30, 1993 (GAO/AIMD-94-109).

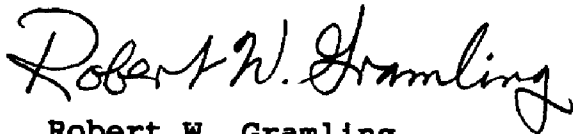
The purpose of this letter is to report to you other matters identified during our audit regarding accounting procedures and internal controls where we believe improvement can be made. While these matters are not considered material in relation to the financial statements, we believe they warrant management's attention. These matters and our suggestions for improvement are discussed in the enclosures to this letter. In cases in which we have been informed that the Corporation has initiated corrective action, we have noted that.

We would appreciate receiving your comments and a description of the corrective actions the Corporation plans to take to address these matters within 30 days from the date of this letter. We are sending copies of this letter to the Executive Director, Chief Financial Officer, and Inspector General of the Pension Benefit Guaranty Corporation. If you have any questions or need assistance in addressing these

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matters, please contact John Reilly, Assistant Director, at
(202) 512-9517 or Kent Bowden, Assistant Director, at
(202) 512-5270.

Sincerely yours,

A handwritten signature in cursive script that reads "Robert W. Gramling".

Robert W. Gramling
Director, Corporate Financial
Audits

Enclosures

GAO/AIMD-94-168ML

SINGLE-EMPLOYER PROGRAM CONTINGENT LIABILITIESSEVERAL UNDERFUNDED PLANS
WERE OMITTED FROM THE
CONTINGENT LIABILITY ASSESSMENT

The Corporation begins its assessment of single-employer contingent liabilities by developing a list of underfunded plans, which may pose a risk of loss to the Single-Employer Program. Two of the primary sources of data from which the Corporation identifies underfunded single-employer plans are a database of public company annual report information and the Corporation's Premium Accounting System. The Corporation, through the use of computer programs, adjusts plan vested benefit liabilities reported in the annual report database and Premium Accounting System to reflect, on a consistent basis, the Corporation's actuarial assumptions.

We found 8 of 110 plans selected from the annual report database and 7 of 78 plans sampled in the Premium Accounting System were incorrectly excluded from the contingency list. For example, for the annual report database, the Corporation excluded those sponsors reporting only overfunded plans that became underfunded after adjusting vested benefit liabilities to the Corporation's actuarial assumptions. The Corporation's inability to identify underfunded plans from the annual report database and the Premium Accounting System may result in future misstatement of contingent liabilities recorded and disclosed in the financial statements.

We suggest that the Corporation document the computer programs and related formulas used to adjust vested benefit liabilities reported in the annual report database and the Premium Accounting System and designate an individual to review those programs and formulas prior to their use in the identification process.

SUPPORT FOR VERY HIGH RISK
REASONABLY POSSIBLE PLANS WAS
NOT ADEQUATELY DOCUMENTED

The Corporation classifies single-employer plans as remote, reasonably possible, or probable according to a set of specified criteria designed to assess the likelihood of loss in accordance with Statement of Financial Accounting Standards no. 5, Accounting for Contingencies. The criteria used to classify underfunded plans are generally based on the financial condition of the plan sponsor. Responsibility for overseeing the preparation of a list of companies sponsoring underfunded plans that fall into the contingency categories noted above is assigned to a Contingency Working Group (CWG), which includes representatives from various

departments within the Corporation. The CWG Procedures Manual requires that the Corporation's financial analysts document the criteria met when recommending plans to be classified as probable or reasonably possible. Furthermore, a CWG memorandum required, although not yet formalized into a procedures manual, that the financial condition of each sponsor considered to be very high risk within the reasonably possible category be analyzed further, with documentation made as to why the plans should or should not be classified as probable.

We found that, although the Corporation documented the reasons for reasonably possible classifications, the financial analysts did not explicitly identify which of those sponsors were considered to be very high risk. This condition likely occurred because the form used to document the classification recommendations did not specifically call for such identification.

We also found that evidence was generally not included in the analysts' case files to support that further analysis had been performed on very high-risk sponsors. For example, we found that only one of 23 reasonably possible case files reviewed contained documentation providing explicit reasons why the plan sponsor should not be classified as a probable. Because documentation supporting the classification of very high-risk sponsors' plans was not adequate, clear classification analysis was not available to facilitate the CWG's review and approval of the classification of such plans. This condition increases the risk that plans may be misclassified. Accordingly, contingent liabilities recorded and disclosed in the financial statements may be misstated in the future.

We have been informed that the CWG plans to revise the classification forms to more clearly identify, for classification purposes, very high-risk sponsors. We also suggest that the CWG Procedures Manual be updated to require that sponsors considered to be very high risk be analyzed further and the reasons why their plans are or are not classified as probable of termination be documented.

CONTINGENCY WORKING GROUP ACTIVITIES
WERE NOT ADEQUATELY DOCUMENTED

The CWG is responsible for overseeing the Single-Employer Program contingent liability assessment process. Specifically, the CWG oversees the identification, classification, and valuation of underfunded plans, reviews and concurs with the contingency list, and reviews recommended plan classifications. Consequently, we considered the CWG's oversight function to represent a significant

internal control in preventing or detecting material errors in the contingency assessment process.

The CWG's oversight function is typically accomplished in the CWG meetings. Thus, we believe the decisions made should be adequately documented in the minutes. Based on our review of the CWG minutes, we found that decisions made both in CWG and subcommittee meetings concerning classification of plans generally were not documented. The usefulness of CWG minutes as a record of its performance of its oversight function is diminished when its deliberations, considerations, and decisions on specific plans are not adequately documented. Furthermore, such documentation is not available to assist senior management in its review and approval of contingent liabilities included in the financial statements.

In addition, the CWG Procedures Manual requires the CWG to monitor events that could affect the Corporation's financial condition between the financial statement date and the date the statements are issued. However, we found that the CWG discontinued its oversight meetings less than a month after fiscal year-end, long before the financial statements were issued. We also found that, although required by the CWG Procedures Manual, supporting documentation had not been provided to the CWG with contingency classification forms for recommended probable classifications.

We suggest that the CWG

- document in its minutes the results of the performance of its oversight function, both in CWG and subcommittee meetings, where recommendations are made to reclassify a plan;
- continue its oversight meetings until the issuance of the financial statements to monitor subsequent events; and
- ensure that supporting documentation is attached to the contingency classification forms to support recommended probable classifications.

SEVERAL REMOTE PLANS DID NOT
UNDERGO CLASSIFICATION REVIEW

The Corporation initially prepares a list of underfunded plans from data maintained in the annual report database and the Premium Accounting System. The Corporation then preliminarily classifies these underfunded plans as posing either (1) a reasonably possible or probable or (2) remote risk of loss by applying standard classification criteria. This preliminary contingency list is

distributed to members of the CWG who may recommend changes based on other information obtained about a plan sponsor.

We found seven plans classified as remote, which the Corporation identified as underfunded through either the annual report database or the Premium Accounting System, that experienced reportable events requiring the plans to be classified as reasonably possible. One of these plans subsequently terminated in fiscal year 1994. This occurred primarily because the Case Processing Division, which receives and processes reportable event notifications, reviewed probability classifications only for those plans that reportable event records reflected as underfunded at a level that warranted inclusion on the contingency list. Unless the Case Processing Division also reviews probability classifications for plans identified as underfunded from the annual report database and the Premium Accounting System, the contingent liabilities recorded and disclosed in the future may be misstated.

We suggest that the Case Processing Division compare the remote plans on the contingency list to those plans that have filed reportable event notifications to determine if any of the plans should be reclassified.

THE CORPORATION DID NOT
SEPARATELY MONITOR CERTAIN
NONPUBLIC PLAN SPONSORS

In order to assess the risk of loss an underfunded plan may pose, the Corporation monitors the financial condition of the plan sponsor. Generally, the Corporation obtains information regarding the financial condition of plan sponsors by reviewing publicly available information. Because single-employer pension plans may be sponsored by either publicly or privately held companies, the Corporation does not have access to the financial information of all plan sponsors for use in its classification process. The Corporation classifies a plan as having a remote likelihood of loss if (1) the plan sponsor does not meet specified probable or reasonably possible criteria or (2) the Corporation does not have sufficient financial information available on the plan sponsor to make a classification decision, such as when the plan sponsor is a privately held company. However, the Corporation's procedures do not require that the Corporation separately identify and monitor those plan sponsors for which financial information is not available. The lack of separate identification and monitoring of such plans limits the Corporation's ability to evaluate any additional risk these plans may pose.

We suggest that the Corporation revise its procedures to require that the Corporation indicate which plans were classified as remote because sufficient plan sponsor financial information was not available. In any instance in which the limited information available on such a plan indicates a significant risk, we suggest that the Corporation evaluate whether increased efforts to obtain further information with respect to the plan sponsor is warranted. Finally, we suggest that the Corporation monitor these plans to determine if they pose an increasing risk to the Single-Employer Program.

CURRENT ASSET DATA WERE
NOT USED IN ESTIMATING
PROBABLE NET CLAIMS

The Corporation's Accounting Policy Manual requires that the amounts of plan assets and liabilities used in estimating net claims for probable terminations be taken from the most current and reliable data available. The Corporation has implemented a procedure whereby other divisions are required to provide the most recent data available to the Actuarial Services Division. However, we found that the Actuarial Services Division did not use the most current data available in performing 2 of the 15 probable single-employer plans' asset valuations we reviewed. Unless the most recent data available are used for the asset valuations, the net claims for probable terminations may be misstated in the future.

We suggest that the Corporation determine why the most recent data were not used for these cases and take steps to ensure that the Actuarial Services Division uses the most recent data available when performing probable plan asset valuations.

LIENS AGAINST COMPANIES WITH
UNPAID PLAN CONTRIBUTIONS WERE
NOT ADEQUATELY TRACKED

The Employee Retirement Income Security Act of 1974, as amended, places liens against companies that fail to make required contributions to single-employer pension plans when the unpaid balance exceeds \$1 million. The Act also requires that employers who fail to make required contributions notify the Corporation within 10 days of the contribution due date. The Corporation's Office of General Counsel perfects liens when it determines that doing so is the most effective strategy for the plan to recover the missed contribution. The Corporate Finance and Negotiation Department maintains an interdepartmental tracking system identifying notifications received and the corresponding liens perfected by the Office of General Counsel. We found that the

Office of General Counsel did not provide the Department with the updated data regarding liens perfected or released (in cases where the plan sponsor subsequently made its contribution). However, the Office of General Counsel did track liens perfected and released in its own spreadsheet program. Because the Department was not receiving feedback from the Office of General Counsel, the interdepartmental tracking system did not provide complete information as to the status of liens initiated in the Department.

We suggest that the Corporation require the Office of General Counsel to periodically notify the Department of liens perfected and released so that the Department can enter this information into its interdepartmental tracking system.

SINGLE-EMPLOYER PROGRAM ESTIMATED RECOVERIES/RECEIVABLESREASONS RECOVERY ESTIMATES
COULD NOT BE MADE WERE
NOT ADEQUATELY DOCUMENTED

The Corporation reports its liability for future benefits net of the amount it expects to recover from the sponsors of terminated plans. These recovery estimates are prepared by financial analysts, with assistance from attorneys, and reviewed by supervisors. In cases in which a recovery is deemed too speculative for reasonable estimation, Corporation procedures require that financial analysts describe the status of the case, the claims the Corporation has asserted, the Corporation's position regarding those claims, and the reasons the Corporation is unable to estimate the value of its claims without significant uncertainties. This information is to be documented on a recovery estimate form.

We found that in 3 of 11 cases we reviewed, the Corporation did not provide all the information required by the recovery estimate form. For example, one recovery estimate description addressed only one of the four required items. An incomplete description limits the effectiveness of the Corporation's review process because supervisors may not have adequate information to agree or disagree with the financial analysts' conclusions. Only by interviewing financial analysts and attorneys were we able to obtain sufficient information to support the Corporation's conclusions.

We suggest that the Corporation require that the supervisors ensure that the information provided by the financial analysts on the recovery estimate form is complete prior to signing off on the form.

TERMINATED PLAN ASSET WAS
INCORRECTLY OMITTED FROM THE
CORPORATION'S FINANCIAL STATEMENTS

The Controller Division's Consolidated Procedures Manual requires that the Investment Accounting Branch maintain the accounting for plan assets after a plan terminates. The Branch receives information regarding plan assets from various sources, including plan custodian banks, plan administrators, plan sponsors, and elsewhere within the Corporation.

We found that one receivable of a terminated plan was omitted from the Corporation's financial statements because the Corporate

Finance and Negotiations Department did not notify the Investment Accounting Branch of an agreement in which a company was obligated to make contributions to the terminated plan. The Case Processing Division, which normally provides the Investment Accounting Branch with plan asset values for terminated plans, had not begun its review of the plan's assets when the financial statements were being prepared and, therefore, was not aware that this receivable existed. This receivable was based on an agreement reached several years earlier when the plan was ongoing. The Corporation negotiates agreements with plan sponsors of ongoing underfunded plans which may include cash contributions, security, or funding guarantees. If the plans eventually terminate, these agreements may affect the Corporation's financial statements.

We suggest that the Corporation implement a procedure to ensure that the Controller Operations Division is notified, at the time of termination, of agreements reached with plan sponsors when the plans were ongoing that have a financial impact on the Corporation.

FINANCIAL ASSISTANCE TO MULTIEMPLOYER PLANSEVIDENCE SUPPORTING BENEFITS AT
OR BELOW GUARANTEED LEVELS WERE
NOT MAINTAINED IN PLAN CASE FILES

The Insurance Operations Department Operations Manual requires that case officers verify that a plan is insolvent and that benefits have been reduced to the guaranteed level specified by the Employee Retirement Income Security Act before financial assistance is provided. A case officer's recommendation to provide or not provide financial assistance and supporting documentation is sent through various supervisory channels for concurrence. In our review of the case file for the one plan which first received financial assistance in fiscal year 1993, we were unable to locate a copy of the plan document or an actuary's statement of the participants' monthly benefit amounts and, therefore, could not determine whether monthly benefit levels were at or below the guaranteed level. Evidence existed that the Corporation had performed a limited analysis and determined that benefits were below guaranteed levels, but there was no written documentation available to corroborate this. The Corporation has begun the process of obtaining documentation to substantiate that current benefit amounts did not exceed the guaranteed benefit level.

The lack of supporting documentation increases the risk that a plan may use the Corporation's financial assistance to make benefit payments that exceed the guaranteed level specified by the Act. We suggest that the Corporation enforce its procedures requiring that

- case officers document the basis for determining that the level of benefits is at or below guaranteed levels;
- written recommendations of case officers, together with supporting documentation, be included in plan case files; and
- written concurrences be obtained from appropriate Corporation personnel prior to the issuance of financial assistance.

PROCESS FOR DETERMINING FACE AMOUNT OF
PROMISSORY NOTES WAS NOT CONSISTENT

The Insurance Operations Department Operations Manual requires that promissory note amounts include the total of financial assistance previously provided plus accrued interest. However, we found that the face amount of the promissory notes for six of the eight plans with outstanding promissory notes as of September 30, 1993, did not

include accrued interest. In addition, we found that, in one of the two cases in which accrued interest was included, the Case Processing Division's calculation of accrued interest included in the face amount of the notes did not agree with the Controller Operations Division's calculation of accrued interest used for recording in the general ledger.

We believe that there is no reason to calculate accrued interest when the principal, which under the promissory note terms is due before interest, is deemed uncollectible. We, therefore, suggest that the Corporation revise its procedures so that promissory note balances represent only the amounts of financial assistance disbursed, exclusive of accrued interest, and designate one department to calculate accrued interest on any loans deemed collectible. Furthermore, we suggest that the Corporation no longer calculate accrued interest on loans until it is determined that the principal balance can be collected.

We have been informed that the Office of General Counsel is revising the note and security agreement formats to state interest terms within the agreement. We suggest that those terms make clear that interest will be calculated and compounded on each individual assistance disbursement and that the amount, date, and interest rate of each disbursement be listed on a schedule made part of the note terms.

PROMISSORY NOTES WERE NOT
ADEQUATELY SAFEGUARDED

Signed originals or copies of promissory notes and security agreements should be safeguarded from loss or misappropriation. We noted one case in which promissory notes for financial assistance provided to a plan were missing from the Controller Operations Division vault. Inadequate safeguarding may affect the Corporation's ability to substantiate amounts recorded in the accounting records or obtain payment from a plan without producing the promissory notes and security agreements.

We have been informed that the Insurance Operations Department is updating its procedures manual to require that case officers forward original notes and agreements to the Controller Operations Division for safekeeping when they receive them. Because the Office of General Counsel may come into possession of original promissory notes and security agreements, we suggest that these procedures also extend to them. We also suggest that a log of outstanding notes and security agreements, based on actual payments made, be maintained in the Controller Operations Division and checked off when such documents are received.

MULTIEMPLOYER PROGRAM CONTINGENT LIABILITIESLACK OF REVIEW AND APPROVAL
OF CHANGES TO THE INVENTORY
OF MULTIEMPLOYER PLANS

The Corporation begins its assessment of the Multiemployer Program contingent liabilities by developing an inventory of all covered multiemployer defined benefit pension plans. The plans' Form 1 premium filings and Internal Revenue Service (IRS) Form 5500 Annual Return filings are primary sources of data for producing the inventory. These forms are compared to each other based on plan sponsor employer identification numbers, plan identification numbers, and other plan characteristics to produce an inventory of multiemployer plans. The Multiemployer Contingency Group (MCG) Procedure Manual requires that plans found not to be multiemployer plans or those no longer existing are to be removed from the inventory and the basis for their removal documented. These plans include duplicate, inactive terminated, and noncovered plans.

The Corporation did not have a requirement that removal decisions be reviewed and approved for duplicate, inactive terminated, or noncovered plans. Consequently, we found that the Corporation had erroneously deleted 3 plans from the inventory while including 14 others that should have been deleted. Moreover, while the Corporation documented the reasons 21 inactive terminated plans should be removed from the inventory, those plans were not removed.

As a result of these conditions, the contingent liabilities recorded and disclosed in the financial statements may be misstated if at-risk multiemployer plans are incorrectly removed from the inventory. Furthermore, Corporation resources may be spent evaluating the financial condition of inactive or noncovered plans.

We suggest that the basis for matching Form 5500s and Form 1s be documented, reviewed, and approved, except where both the employer identification number and plan identification number match exactly. We also suggest that any additions to or deletions from the inventory of plans be documented and approved prior to entry into the inventory and reviewed afterwards to ensure that the corrections have been input correctly. Finally, we suggest that all reviews and approvals be evidenced by the initials or signature of the reviewing and approving official.

DATA USED IN MULTIEMPLOYER
RATIO SCREENING PROCESS
WERE INADEQUATE

The Corporation uses certain financial and nonfinancial ratios to identify multiemployer plans which pose no significant risk of insolvency. Such plans are excluded from further analysis. These ratios are calculated from information reported by plans to IRS on Annual Return Form 5500. IRS provides the Corporation data tapes containing the Form 5500 information. The tapes used in the 1993 assessment, however, were not complete with respect to the data needed to calculate certain ratios. Furthermore, the Corporation used the information from these data tapes without determining if the Form 5500 information had been input accurately.

Of the 2,116 plans in the Corporation's inventory of multiemployer plans, approximately 40 percent did not have retiree vested and total vested benefit liability amounts included in the IRS data tapes. In these instances, if the IRS data tapes included other actuarial measures of benefit liabilities from the Form 5500, the Corporation estimated the retiree and total benefit liability amounts by multiplying the other actuarial measures by a fixed percentage. As a result, the Corporation was only able to estimate the benefit liability amounts for 60 percent of the plans for which the IRS data tapes omitted the actual amounts. In some instances, the Corporation attempted but was unable to obtain copies of Form 5500s for plans which did not have the alternative benefit liability measures included in the data tapes.

After completing the fiscal year 1993 assessment of the Multiemployer Program contingent liabilities, the Corporation received updated data tapes from IRS which provided actual retiree and total vested benefit liability amounts for approximately 80 percent of those plans for which the Corporation had used estimated amounts in its ratio screening. If the Corporation had used the actual amounts, three plans previously excluded based on estimated data would not have been excluded from further analysis. We also found that MCG's review and approval of the fixed percentages used to calculate the estimated amounts and the data underlying them were not documented. Consequently, the Corporation's use of potentially inaccurate plan data and estimated liability amounts may result in unrecorded and undisclosed contingent liabilities if plans are improperly excluded from further analysis.

We suggest that

-- data from which ratio screening is performed be tested for input accuracy, either by relying on controls IRS may have used to

ensure data input accuracy or by tracing selected data from the data tapes to Form 5500;

- the Corporation seek to obtain actual data from plan administrators or other sources whenever actual current data are not available;
- MCG review the underlying evidence supporting the methodology for projecting or otherwise estimating benefit liabilities before approving its use in the assessment process;
- any key data received from IRS subsequent to completion of the multiemployer plan assessment process be used to recalculate screening ratios or otherwise determine if the initial determinations remain accurate in light of the new data; and
- any corrections to data based on information obtained in performing the above steps be documented and approved prior to entry into the Corporation's database and reviewed afterwards to ensure that the corrections were input correctly.

AVAILABLE INFORMATION WAS NOT
USED TO IDENTIFY AND CLASSIFY
TERMINATED MULTIEMPLOYER PLANS

The MCG Procedures Manual requires that all available data on plan terminations and mergers be reviewed to determine if a plan should be included in the inventory of multiemployer plans. Two sources available to identify such events are reportable event notifications, which the Employee Retirement Income Security Act requires plans to send to the Corporation, and information on plan terminations or mergers required to be reported on the Form 5500.

We found that the Corporation did not utilize its database of reportable event information or the IRS data tapes containing Form 5500 information to identify terminated plans. Our search of 1991 and 1992 Form 5500 data disclosed eight plans that were reported as having terminated but were not treated by the Corporation as terminated for classification purposes. Consequently, the Corporation made no attempt to determine whether these plans were closed out or, if a plan remained active, obtain more current financial information to aid in assessing probability of loss. While five of the plans were overfunded according to the most recent data available, three plans were underfunded or missing data necessary to determine the plan's funding status.

The Multiemployer Program's contingent liabilities recorded and disclosed could be misstated if terminated plans are not identified

and, therefore, are classified without knowledge of the plan's current financial and operational condition. Accordingly, we suggest that the Corporation develop and maintain a current, complete, and accurate database of information on plans with outstanding reportable events for use in its assessment of contingent liabilities.

Specifically, we suggest that the Corporation

- periodically reconcile the database of plans with reportable events to the IRS Form 5500 data tapes to ensure that terminated plans are identified; and
- follow-up with plan administrators to determine which plans in the database have closed out and which are ongoing, and remove from the inventory those plans that have closed out.

REQUIRED PLAN INFORMATION WAS
NOT CONSISTENTLY OBTAINED
FROM PLAN ADMINISTRATORS

The MCG Procedures Manual requires that plan administrators be contacted to attempt to obtain any information pertinent to making decisions about a plan's probability of loss classification or liability valuation. Plans for which the Corporation needs to obtain additional financial and nonfinancial information include those that failed a significant number of screening ratios, have been initially classified as either probable or reasonably possible, or possess any other characteristic that warrants follow-up with the plan's administrator.

Plans that consistently fail a significant number of screening ratios or have a worsening trend in either (1) the number of ratios failed or (2) the magnitude by which the ratios deviate from the Corporation's established parameters may have a higher risk of needing financial assistance should significant events occur subsequent to the date of the Form 5500 data available to the Corporation. We found that the Corporation had not obtained sufficient evidence supporting the remote classifications for nine plans that failed a significant number of screening ratios. Unless the Corporation obtains current data on high-risk plans, the potential exists for a misstatement of the contingent liabilities recorded and disclosed.

The Corporation's procedures require that plan cash flows and other financial and operational information be considered in classifying plans and valuing the Corporation's contingent liabilities for future assistance. We found that four plans were classified as

probable of requiring financial assistance without evidence of the amount, payment intervals, or expected collectibility of amounts from plan sponsors for their share of plan underfunding. Unless such information is obtained and considered, probable and reasonably possible contingent liabilities may be misstated.

We suggest that the Corporation

- place plans which fail or have consistently failed a significant number of screening ratios or otherwise demonstrate a worsening financial condition on the Corporation's existing "watch list" of plans for closer monitoring;
- regularly request current audited financial statements and actuarial reports from plan administrators in order to better monitor the financial condition of plans that may pose a risk to the Corporation; and
- contact the plan administrators of terminated plans and attempt to obtain information on the amounts, timing, and likelihood of collection of expected withdrawal liability collections (for example, payment schedules agreed upon with the companies), and incorporate this information into the Corporation's probability classification and valuation decisions.

PLANS WITH HIGH-RISK
ASSET CONCENTRATIONS WERE
NOT ADEQUATELY REVIEWED

The MCG Procedures Manual requires a probability classification for underfunded plans with a concentration of high-risk assets, such as real estate, mortgages, and employer contribution receivables. However, for fully funded plans with concentrations of high-risk assets, these procedures call for the plans to be classified as remote.

We found that, while probability classifications were assigned to underfunded plans with such asset concentrations, the Corporation's procedures did not require that current and specific information on the nature of these high-risk assets be obtained to aid in assigning probability classifications. Furthermore, commercial loans secured by mortgages are not required to be included in the calculation of the ratio of real estate assets to net assets. Because of the conditions described above, the potential exists that the Corporation may not record or disclose a contingent liability for plans which pose a risk of loss to the Multiemployer Program.

We believe that multiemployer plans with concentrations of high-risk assets pose a potential risk of insolvency and, thus, may require financial assistance from the Corporation even if the plan is fully funded as of a particular date. Events and plan transactions subsequent to that date may adversely affect the financial condition of the plan and, therefore, its probability classification.

We suggest that the MCG Procedures Manual be revised to require that the most current audited financial statements for all plans with concentrations of high-risk assets, regardless of funding status, be obtained. Furthermore, we suggest that the nature of these assets and their potential effect on the plan's ability to pay future benefits when due be reviewed to ensure that the plan is properly classified. We also suggest that the ratio of real estate to net assets be modified to include commercial loans secured by mortgages.

PREMIUM REVENUECONTROLS OVER PREMIUM REFUNDS
NEED TO BE STRENGTHENED

The Corporation's controls should ensure that premium refund requests are appropriately tracked and resulting refunds are appropriately disbursed. The Premium Operations Division Manual requires that the Corporation attempt to assign premium refund requests from a given plan to the same analyst for processing and that the supervisors perform specified review steps. We found that at least two duplicate checks had been issued and cashed and that 26 others had been approved for disbursement but were subsequently canceled by the Department of Treasury. Duplicate refunds were issued because (1) the Corporation's system for maintaining control of premium-related correspondence with plan administrators allowed different analysts to be assigned to process refund requests from a given plan and (2) the supervisor approved the refund requests without performing all the required review steps. If these conditions continue, the potential exists that duplicate refunds may be issued in the future.

We suggest that the Corporation

- revise the Premium Operations Division Manual and enhance the correspondence system to ensure that only one analyst receives refund requests from a given plan and
- enforce its supervisory review procedures.

We have been informed that the Corporation has awarded a contract for establishing a new correspondence system. The new system is expected to improve reliability in premium processing, particularly with premium refunds. Furthermore, a contractor has been assigned to recommend and implement procedures to strengthen the controls over premium refunds. In our subsequent audit, we will assess the effectiveness of the actions taken to improve the premium refund process.

FINANCIAL REPORTINGACCOUNTING POLICIES FOR
MEASURING LOSSES FROM TERMINATIONS
AND CERTAIN TRANSACTIONS CAN LEAD TO
MISSTATEMENTS IN THE FINANCIAL STATEMENTS

The Corporation records its losses from actual plan terminations as the difference, measured as of the proposed legal date of termination,¹ between (1) the benefit liabilities to be assumed by the Corporation and (2) related plan assets and estimated recoveries. However, such losses are recorded at the date the Corporation commences termination proceedings, which can be months or years after the proposed legal date of termination. Between these dates, the plans continue to operate. To account for the resulting changes in plan values, the Corporation records in the current period the plans' transactions incurred between these two dates as its own transactions. We believe that this practice is inappropriate because (1) these transactions are those of parties other than the Corporation and (2) some transactions occurred in prior periods. We believe that subsequent changes in estimated plan values should be reported as changes in the losses from plan terminations.

Moreover, the Corporation records interest income when adjusting the values of estimated recoveries, which are reported as offsets to the Corporation's benefit liabilities, to reflect current values. We believe that changes in estimated recovery values should be reported as changes in the losses from termination until settlement agreements are reached with plan sponsors to establish the amounts due the Corporation.

The effects of the Corporation's practices just discussed may result in misstatements of individual line items in future financial statements. We, therefore, suggest that the Corporation develop accounting policies so that the recorded losses from actual plan terminations include the changes in estimated plan values (1) between the proposed legal termination date and the date the Corporation commences termination proceedings and (2) between the commencement date and the date estimated plan values are finally determined.

¹Legal date of termination is typically finalized by court action at a later date.

INTERFUND ALLOCATIONS WERE BASED
ON INCORRECTLY CALCULATED RATIOS
AND INCONSISTENT METHODS

Consistent with the Corporation's accounting policy, revolving fund investment assets and related net earnings on those assets were allocated to each program's revolving fund to the extent that such amounts were not directly attributable to a specific fund. Revolving fund investment earnings were allocated on the basis of each program's average cash available for investment during the year. Revolving fund investment assets were allocated on the basis of the year-end equity of each program's revolving fund.

We found errors in the allocation ratios which resulted from the omission of certain amounts from the calculation and from the allocation of one account balance that should not have been allocated. These errors occurred because (1) the cash receipts and disbursements used in the revolving fund allocation schedule were not compared to the revolving fund cash flows statement amounts and (2) the income resulting from the amortization of discount on zero coupon bonds was credited to an account whose method of allocation was not described in the Financial Statement Preparation Procedures Manual and, therefore, was assumed to require allocation. We also found that other revolving fund asset and income accounts had been added to the chart of accounts for which the manual had not been updated to include. Furthermore, the methods of allocating revolving fund investment assets, earnings, and related cash flows were not consistent. Accordingly, the relationship between transactions and account balances, as presented in the financial statements, can be affected when allocated on different bases.

We suggest that the cash flows amounts used in the calculation of the ratio of average amounts available for investment be compared to the revolving funds' cash flows statements as part of the review and approval of the revolving funds allocation schedule. We also suggest that the Financial Statement Preparation Procedures Manual be updated as accounts are added or deleted. Furthermore, we suggest that the Corporation monitor the effects of allocating related revolving fund transactions and account balances using different methods.

TRUST EQUITY OFFSET ACCOUNTS
DID NOT PROPERLY NET TO ZERO

The Corporation accounts for the operations of its insurance programs through a combination of revolving and trust funds. The Corporation's three trust funds contain equity accounts that offset the recordation of the net assets of terminated plans and trust

fund transactions. Although the offset accounts should net to zero, none of the three trust funds' equity accounts did. The fact that the accounts did net to zero in total, though not individually, at the beginning of the fiscal year, suggests that an error may have arisen from the posting of closing or asset acquisition/liquidation transactions to the three trust funds at the end of the prior year. Depending on the nature of the errors, the allocation of trust fund income and expense among funds may be affected.

We suggest that the Corporation review those transactions affecting the trust fund equity accounts in fiscal years 1992 and 1993 to identify any error that might have been made in calculating, preparing, and posting the transactions and take the appropriate action to ensure that such errors are identified and corrected in the future. We suggest that those transactions of the Multiemployer Program trust fund be reviewed first because the limited number of transactions may help isolate the error.

THE CORPORATION RELIED ON UNAUDITED
CUSTODIAN BANK REPORTING

The Corporation contracts with a bank for the custody of assets the Corporation acquired from terminated plans. As the Corporation's custodian bank, it executes investment transactions and maintains accountability for the assets. These transactions are subject to the bank's internal control policies and procedures.

The custodian bank contracted with an independent auditor to test and report on the internal controls for its trust custody services. The service auditor's report stated that the results of its testing were satisfactory to conclude that the policies and procedures for the bank's custody functions applicable to the processing of transactions and safekeeping of assets for its customers were operating with sufficient effectiveness to provide reasonable assurance that the bank's control objectives were achieved. However, the report did not provide assurance on the reporting services provided by the bank to its trust customers nor was the scope of the audit intended to do so.

As part of its reporting function, the custodian bank provided the Corporation with monthly investment activity reports which the Corporation used as a basis for accounting entries which ultimately were reflected in its financial statements. The Corporation performed limited independent checks of the data to ensure the accuracy of the reports. With only limited independent checks performed by the Corporation and the lack of assurance as to the custodian bank's reporting services, the potential exists that the

bank's reports may contain errors which, if not detected, could result in misstatement of the Corporation's financial statements.

We suggest that the Corporation obtain reasonable assurance that the custodian bank's reports contain accurate data by either performing a more comprehensive review of the reports or ensure that the custodian bank extends the scope of the trust custody services audit to include the reporting services of trust activities.

ELECTRONIC DATA PROCESSINGACCESS TO THE MAINFRAME SECURITY
SYSTEM WAS NOT ADEQUATELY LIMITED

Only those users whose duties require it should have access to certain functions in the Corporation's mainframe security system. We found that some users had access to security privileges, system functions, files, data sets, and utility programs not necessary for their assigned duties. Such access was not adequately limited because established security policies and procedures were not followed. Most of these privileges bypassed existing access control features of the mainframe security system. Thus, these privileges increased the risk of unauthorized or accidental system access.

We suggest that the Corporation review the user IDs which allow access to special privileges. Only users who require these privileges to perform their assigned duties should be authorized to have them.

GENERIC USER IDS WERE
FOUND IN THE SYSTEM

Individual user IDs should be established by security administration to ensure that users can be held accountable for their actions. We found that generic user IDs were used in the Corporation's mainframe system because established security policies and procedures were not followed. The use of shared generic system IDs prevents individual user accountability for specific system actions and may potentially compromise established segregation of duties controls.

We suggest that the Corporation discontinue the use of generic IDs. We have been informed that the Corporation is in the process of eliminating these IDs.

PROCEDURES WERE NOT IN PLACE TO IDENTIFY
INVALID ACCESS ATTEMPTS BY EXTERNAL USERS

Invalid attempts to access the Corporation's mainframe system by modem should be documented and reviewed to monitor hacker intrusion attempts. The Corporation's report which documents invalid access attempts did not distinguish between attempts made by internal and external users. This occurred because internal and external users shared the same dial-up lines into the system, making it difficult to determine the origin of an attempted connection. As a result,

hacker intrusion attempts, if any, from external users could not be identified, monitored, and investigated promptly.

We suggest that the Corporation implement procedures to ensure that invalid dial-up attempts by modem are promptly monitored. We have been informed that the Corporation recently purchased a software package which will restrict access by modem and facilitate reporting of invalid external dial-up attempts.

PROCEDURES TO RESTRICT ACCESS TO
WIRE TRANSFER SYSTEM WERE NOT ADEQUATE

User access privileges to the Treasury Department's wire transfer system used by the Corporation should be removed when a user leaves the Corporation or changes duties and no longer needs access. We found one user with security control privileges in the wire transfer system who, due to a change in job responsibilities, no longer required such privileges. This occurred because procedures had not been established to revoke privileges of users whose job responsibilities no longer warranted them. Untimely revocation of user access privileges increases the risk of unauthorized system access.

We suggest that the Corporation implement procedures to ensure that the wire transfer system privileges of transferred users be revoked on the date of transfer. We have been informed that the security administration privileges for the user noted above have been removed.

ACCESS CONTROLS TO THE
CORPORATION'S TAPE MANAGEMENT
SYSTEM WERE NOT EFFECTIVE

Access to the Corporation's system used to manage its computer mainframe data stored on tapes should be restricted to authorized personnel. At the time of our audit, the Corporation had not yet changed the default password supplied with this system. We were able to access the system using the default password as documented in the software manual. This condition existed because the technical support personnel who installed the system were not aware of the requirement to change the default password. The existence of default passwords increases the risk of unauthorized access to computer resources.

We suggest that the default password supplied with the system be changed.

TEST AND PRODUCTION ENVIRONMENTS
FOR MULTIEMPLOYER PLAN PROGRAMMING
WERE NOT ESTABLISHED

Separate test and production environments should exist to control program development. Programs under development should reside in a test environment where they are changed, debugged, and tested by programming personnel. Completed programs should reside in a production environment after a formal testing and quality assurance process. Access to production libraries should be restricted to a limited number of authorized users.

We found that the Corporation did not maintain separate test and production environments to control the development of programs used in the Multiemployer Program contingent liability process. Such programs in development were not maintained in a library separate from programs in production.

Furthermore, poor control over frequent changes to programs used to extract and manipulate multiemployer plan data caused problems in reporting complete and accurate multiemployer plan results. We noted that copies of source code and program logs were not maintained to provide an audit trail of the program logic used, access permitting the programs to be changed was not restricted, and review and approval procedures for program changes were not regularly performed.

We suggest that the Corporation establish separate test and production environments for multiemployer plan program development and that changes to those programs be more carefully controlled in order to reduce the risks of program errors and unauthorized access.

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