United States General Accounting Office

GAO

Report to the Ranking Minority Member, Special Committee on Aging, U.S. Senate

February 2003

PENSION BENEFIT GUARANTY CORPORATION

Statutory Limitation on Administrative Expenses Does Not Provide Meaningful Control

GAO

Accountability ★ Integrity ★ Reliability

GAO-03-301

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GAO Highlights

Highlights of GAO-03-301, a report to the Ranking Minority Member of the Special Committee on Aging, United States Senate

Why GAO Did This Study

Concerned about the increasing proportion of the Pension Benefit Guaranty Corporation's (PBGC) operational and administrative budget that is outside the annual administrative expense limitation, the Ranking Minority Member of the Senate Special Committee on Aging asked GAO to review PBGC's (1) application of the limitations set forth in its appropriations in developing its budget estimates and (2) methodology for allocating and reporting its operational and administrative expenses falling under the statutory limitation.

What GAO Recommends

Congress may wish to review whether or to what extent to continue including an administrative expense limitation in annual appropriation acts as an oversight tool. GAO is making recommendations to PBGC aimed at developing cost information to assist Congress in its oversight of PBGC's activities and for congressional decision making about whether and to what extent it should continue to use an expense limitation in its oversight of PBGC. PBGC stated that its budget structure must change; however, its proposed revisions would not specifically address GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-03-301.

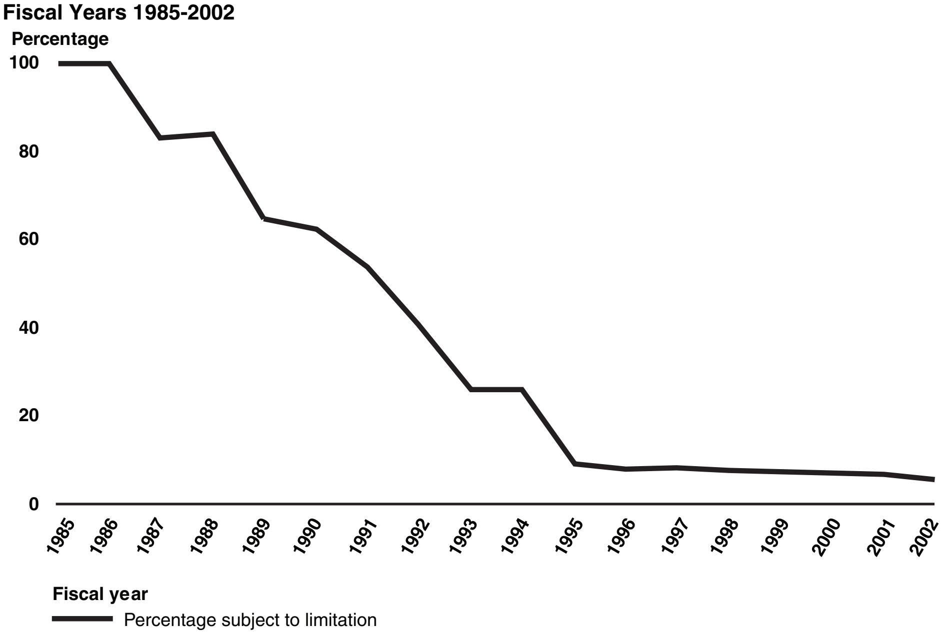
To view the full report, including the scope and methodology, click on the link above. For more information, contact Jeanette Franzel at (202)512-9406 or at franzelj@gao.gov.

What GAO Found

As part of PBGC's fiscal year 1985 appropriation, Congress limited the amount of PBGC's appropriated revolving funds available for "administrative expenses." In later years, PBGC requested and Congress approved certain types of expenses to be excluded from the administrative expense limitation. PBGC requested the exclusions in order to gain flexibility in dealing with several major pension plan terminations. The exclusions, combined with PBGC's application of the limitation, have resulted in only 5 percent of PBGC's administrative and operational expenses being included in the limitation for fiscal year 2002. GAO found significant problems with the way PBGC develops its proposed budget estimates for activities covered by its administrative expense limitation. PBGC does not have a reliable basis for estimating its administrative expenses subject to the legislative limitation. As a result, PBGC's estimates for its activities covered by the limitation are not meaningful and thus are ineffective in controlling administrative costs.

In addition, PBGC does not have a meaningful basis for reporting adherence to the limitation, since it does not accumulate and allocate actual expenses for activities subject to the limitation. PBGC uses its budgeted amount for the administrative expenses limitation as a basis for allocating and reporting actual costs for those activities. This amounts to force fitting reported expenses so that they equal or come close to the budgeted amount for the limitation, and accordingly, does not provide reliable cost data related to actual activities or a meaningful basis for reporting and tracking compliance with the limitation.

Percentage of PBGC's Operational and Administrative Expenses Subject to Limitation, Fiscal Years 1985-2002



Contents

Abbreviations

CMO	Chief Management Officer
ERISA	The Employee Retirement Income Security Act of 1974
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation

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

February 28, 2003

The Honorable John Breaux
Ranking Minority Member
Special Committee on Aging
United States Senate

Dear Senator Breaux:

The Pension Benefit Guaranty Corporation (PBGC) insures the benefits of 44 million participants on default of their employer-sponsored defined benefit pension plans.[1] Established by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA)[2] as a wholly owned government corporation, PBGC's primary activities involve collecting insurance premiums from pension plan sponsors, overseeing plan terminations, and ensuring the proper disbursement of payments. During fiscal year 2002, PBGC received $812 million in premium income and paid over $1.5 billion in retirement benefits. ERISA requires that PBGC's activities be self-financing. PBGC finances its activities primarily through premiums collected from covered plans, assets received from terminated plans, collection of employer liabilities due under ERISA, and investment earnings.

Amid congressional concerns that PBGC had not informed Congress of prior-year commitments for a large office automation project, PBGC's fiscal year 1985 appropriation limited its use of its appropriated revolving funds for annual administrative expenses to $33.1 million, which included all of PBGC's operational and administrative expenses at that time.[3] Since fiscal year 1985, PBGC's operational and administrative budget has grown significantly, to $227.2 million for fiscal year 2002, while the administrative expenses limited by annual appropriations acts have fallen to $11.7 million, or 5.2 percent of the total operational and administrative budget.

[1]Defined benefit pension plans are established or maintained by employers or employee organizations, or both, and provide for a specific amount of retirement income with the payment amounts typically based on years of service, income, and earnings.

[2]Pub. L. 93-406, Title IV, 88 Stat. 1003, Sept. 2, 1974. PBGC's enabling legislation, as amended, is codified at 29 U.S.C. §§ 1301 – 1461 (2000).

[3]Pub. L. 98-619, 98 Stat. 3307, Nov. 8, 1984.

In your December 18, 2001, letter, you expressed concern about the increasing proportion of PBGC's operational and administrative budget that is outside of the annual administrative expense limitation. In that regard, you asked us to (1) describe the evolution of PBGC's current statutory limitation on administrative expenses, (2) review PBGC's application of the limitations set forth in its appropriations in developing its budget estimates, and (3) review PBGC's methodology for allocating and reporting its operational and administrative expenses falling under the statutory limitation.

Results in Brief

As part of PBGC's fiscal year 1985 appropriation, Congress limited the amount of PBGC's appropriated revolving funds available for "administrative expenses" to $33.1 million. In fiscal years 1989 and 1991, at PBGC's request, Congress identified types of expenses to be excluded from the administrative expense limitation. With the statutory exclusions and PBGC's flawed process for estimating its budget for and applying the administrative expense limitation, the portion of PBGC's expenses subject to the limitation compared to its operational and administrative budget have decreased dramatically, from 100 percent in fiscal year 1985 to 5.2 percent in fiscal year 2002. The President's proposed Budget of the United States Government, Fiscal Year 2004, released on February 3, 2003, proposes the elimination of the administrative expense limitation.

We found significant problems with the way PBGC developed its budget estimates for activities covered by its administrative expense limitation. As a result, PBGC's estimate for activities covered by the budget limitation is not meaningful or reliable. PBGC officials could not demonstrate that they had conducted an analysis of expense classifications for its activities under the operational and administrative budget since PBGC last reviewed its activities in 1993. Regarding PBGC's budget estimates for expenses subject to the limit, we identified flaws in the concepts supporting the calculation. PBGC's estimates did not include any direct expenses and included only the amount of indirect expenses that was not allocated to other activities. Under this process, for fiscal year 1995, PBGC determined the amount of its proposed budget subject to the administrative expense limitation to be $11.5 million. PBGC has used this amount as a basis for all subsequent annual budget proposals without subsequent validation, even though the scope and size of PBGC's operations have expanded significantly since fiscal year 1995.

We also found that PBGC's reporting of administrative expenses that fall under the administrative expense limitation is not meaningful. PBGC does not use a transaction-based approach to report and track actual expenses covered by the limitation. Instead, PBGC uses its budgeted amount for the administrative expenses limitation as a basis for allocating and reporting actual costs for those activities. This amounts to force fitting reported expenses so that they equal or come close to the budgeted amount for the statutory limitation, and accordingly, does not provide reliable cost data related to actual activities or a meaningful basis for reporting and tracking compliance with the limitation.

While the initial statutory provision provided cost control over PBGC's entire operational and administrative budget, the administrative expense limitation now represents an increasingly smaller segment of those costs. Congress may wish to review whether to continue including such a limitation in appropriations acts as an oversight tool. If a statutory limitation for controlling costs continues to be desirable, Congress may wish to reexamine the scope of the limitation and require PBGC to apply and report on the limitation in a more meaningful manner.

We are making recommendations to PBGC aimed at developing cost information to assist Congress in its oversight of PBGC's expenses and to aid congressional decision making about whether or to what extent it should continue to use an expense limitation in its oversight of PBGC.

In commenting on a draft of this report, the Chief Management Officer (CMO) of PBGC noted that the Corporation had reached a conclusion similar to ours about the clarity of PBGC's current budget structure and stated that the budget structure must change. PBGC's CMO also expressed concern that our report appears to be stating that PBGC's budget structure does not provide Congress with meaningful control and disagreed with our conclusion that its reporting processes are not based on actual data. However, our report addressed the administrative expense limitation and not PBGC's overall budget. As we stated in our report, we found significant problems with the way PBGC developed its budget estimates for activities covered by the administrative expense limitation as well as with PBGC's reporting of actual expenses covered by the limitation. The percentage of PBGC's expenses subject to the limitation has fallen significantly while its total operational and administrative expenses have increased significantly—resulting in only 5 percent of its expenses falling under the administrative expense limitation. Accordingly, the limitation as now structured and implemented does not represent a meaningful control over administrative expenses. PBGC proposed a restructuring of its budget, but this proposal does not specifically address our recommendations.

Scope and Methodology

To describe the evolution of PBGC's current statutory limitation on administrative expenses, we reviewed PBGC's enabling and appropriations legislation from 1974 to 2002. We reviewed Titles I and IV of ERISA (29 U.S.C. Chapter 18); Chapter 91 of Title 31, United States Code (commonly referred to as the Government Corporation Control Act); the Treasury-General Government Appropriations acts for various fiscal years; and pertinent legislative histories of those acts.

In order to review PBGC's application of the statutory limitations in developing its budget estimates for amounts falling under the limitation, we reviewed the 1985-2003 *Budget of the United States Government;* PBGC's 2002 annual report and financial statements; related audit reports, budget submissions, and proposals; and other publications and official correspondence dealing specifically with PBGC's budget limitations.

To review PBGC's methodology for allocating and reporting its operational and administrative expenses for activities falling within the administrative expense limitation, we reviewed key documents from PBGC's budget formulation and execution process and interviewed PBGC officials knowledgeable about the process. We analyzed PBGC's budget policy manual, mission and function descriptions for each PBGC department, and PBGC's budget justification documents. We obtained and reviewed the 2001 budget execution reports submitted by PBGC to the Office of Management and Budget (OMB), including the Apportionment and Reapportionment Schedules (SF 132) and Reports on Budget Execution and Budgetary Resources (SF 133). We reviewed PBGC's budgetary accounting code structure and obtained copies of budgeting and accounting documents applying those codes. We also interviewed PBGC's Budget Director, Controller, Chief Management Officer, and other appropriate PBGC officials.

As agreed with your staff, we did not review the relationship of PBGC's revolving funds to the trust funds it administers as trustee of defined benefit pension plans because this matter is subject to ongoing litigation.[4]

[4] Pineiro v. Pen. Ben. Guar. Corp., 22 Fed. Appx. 47 (2nd Cir. 2001).

Accordingly, we did not review individual expense transactions for the purpose of determining whether they should be properly charged to the revolving or trust funds.

We conducted our review from March 2002 through December 2002 in accordance with generally accepted government auditing standards. We obtained written comments on a draft of this report from PBGC's Chief Management Officer. These are included in appendix IV.

Background

Congress enacted ERISA in 1974 to protect the anticipated retirement benefits of employees when defined benefit pension plans they participate in are terminated and do not have sufficient assets to pay the estimated future benefits promised to employees (underfunded plans). Defined benefit pension plans are established or maintained by employers or employee organizations, or both, and provide for a specific amount of retirement income with the payment amounts typically based on years of service and earnings.

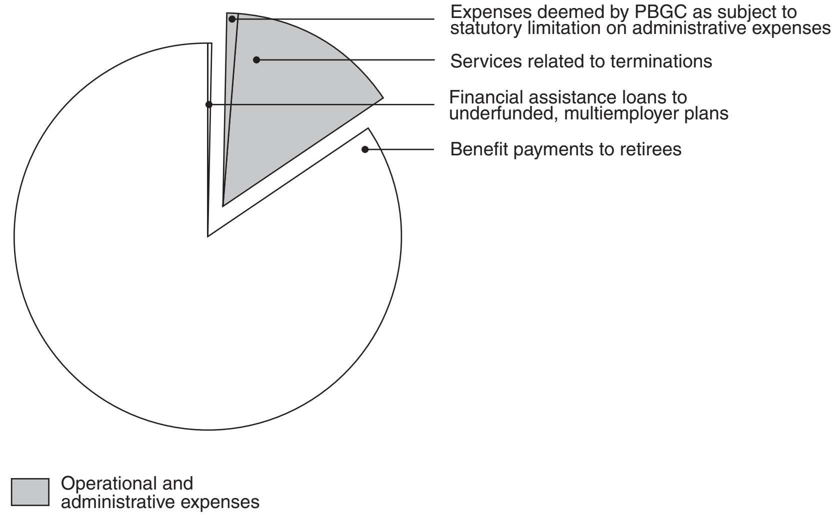
PBGC insures participants for single-employer and multiemployer defined benefit pension plans. Single-employer plans generally consist of plans that provide benefits to employees of one employer. Multiemployer plans are those established through collective bargaining agreements that require contributions by and provide benefits to workers from more than one employer. PBGC charges a flat-rate premium or a variable-rate premium to finance its coverage of amounts needed to guarantee benefit payments of plans that terminate with insufficient assets to pay promised benefits. PBGC initiates involuntary terminations for underfunded plans. Once those plans are terminated, PBGC routinely is appointed as the permanent trustee. (App. I summarizes the plan termination processes in more detail.)

As shown in figure 1, PBGC's major expenditures include benefit payments, financial assistance payments, and "operational and administrative" expenses. Under the single-employer program, PBGC makes guaranteed benefit payments to retirees or their dependents for underfunded terminated plans.[5] Under the multiemployer program, PBGC provides

[5]An underfunded plan may terminate only if PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if PBGC terminates a plan under specified statutory criteria.

financial assistance payments to pension plans that become insolvent. This allows the plans to continue paying participants their guaranteed benefits.

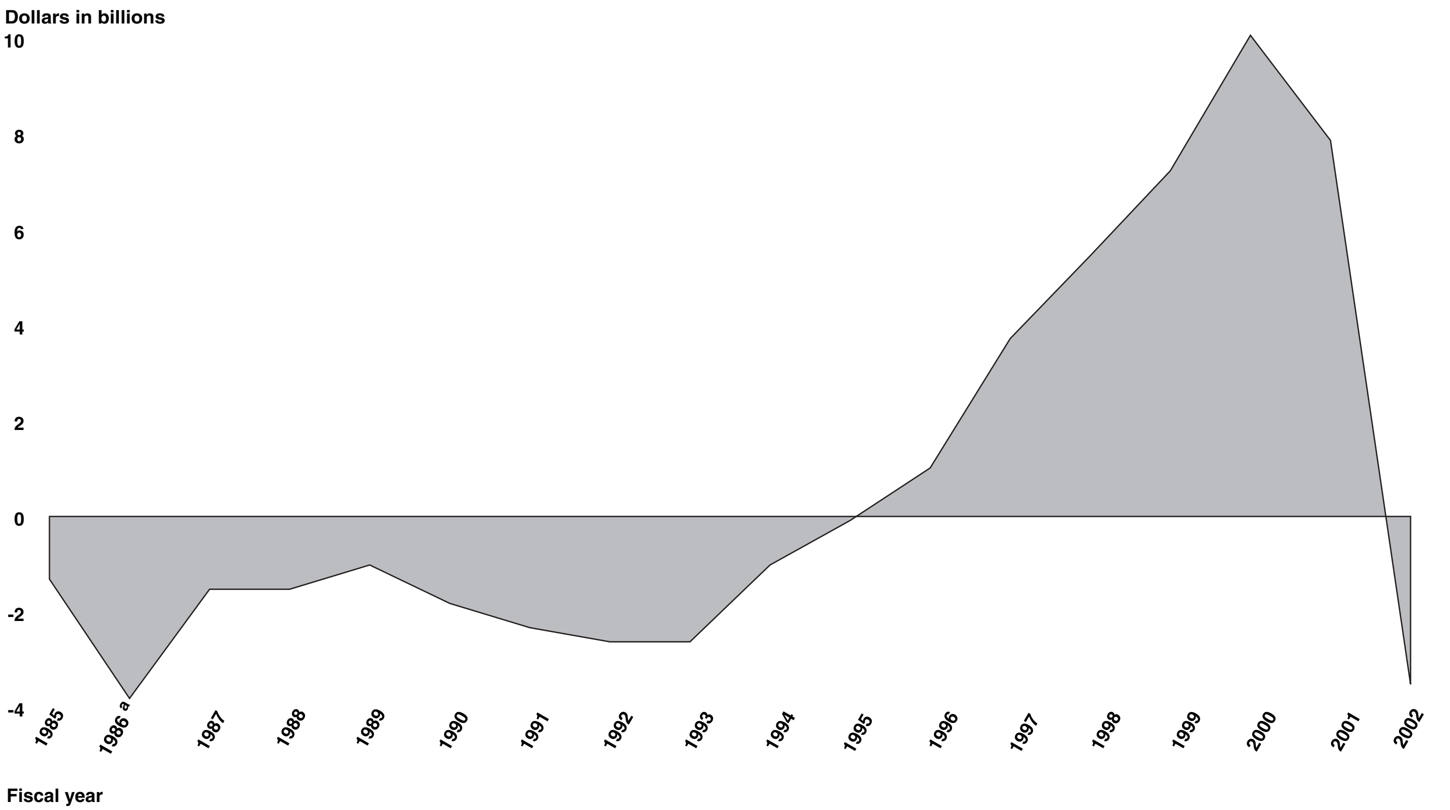
Figure 1: Major Types of PBGC Expenditures



Source: PBGC data, GAO analysis.

PBGC's operational and administrative expenses include expenses incurred in carrying out its responsibilities as trustee of plans and its administrative expenses. PBGC's expenses as a trustee include the costs of collecting plan assets; processing, accounting, valuing, and managing assets; determining eligibility and benefit levels; and paying benefits. PBGC divides its operational and administrative expenses into two subcategories: "services related to terminations" and "administrative." PBGC treats all expenses of "services related to terminations," including an allocation of indirect expenses, as expenses related to its role as trustee of plans. PBGC charges those expenses to its trust funds. (App. II discusses PBGC's revolving and trust funds.) Over the years, PBGC operations have grown significantly as pension plan terminations have increased. PBGC's reported net position increased from a negative $1.3 billion in fiscal year 1985 (total assets of $1.2 billion against $2.5 billion in recorded liabilities) to $7.8 billion in fiscal year 2001 (total assets of $22.5 billion against $14.7 billion in recorded liabilities). In fiscal year 2002, PBGC's net position decreased to a deficit of $3.5 billion (total assets of $26.4 billion against $29.9 billion in recorded liabilities). The large decrease in PBGC's net position in fiscal year 2002 was due largely to losses associated with completed and probable pension plan terminations. The number of pension plan participants that PBGC is responsible for increased from 170,000 in fiscal year 1985 to 783,000 in fiscal year 2002, an increase of 361 percent. PBGC's net position from fiscal year 1985 through 2002 is reflected in figure 2.

Figure 2: PBGC Net Position—Fiscal Years 1985-2002



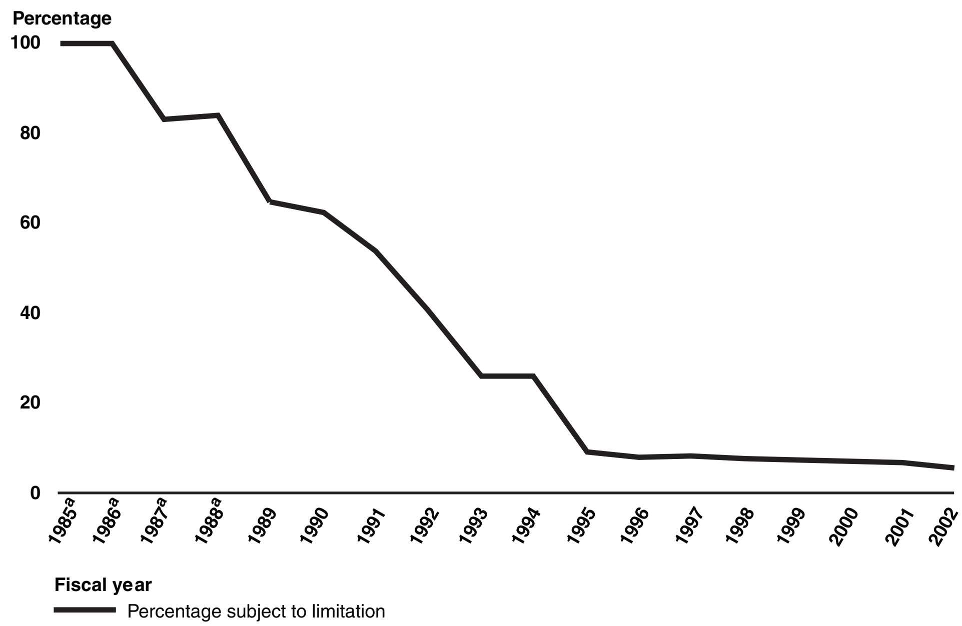
Source: PBGC data, GAO analysis.

[a]Fiscal year 1986 includes $1.8 billion in liabilities that was subsequently returned by a Supreme Court ruling to a reorganized LTV Corporation.

Evolution of PBGC's Current Statutory Limitation on Administrative Expenses

In annual appropriations acts since fiscal year 1985, Congress has limited the amount of PBGC's permanent indefinite revolving fund appropriations that may be used for administrative expenses. The annual appropriations acts have not defined the types of costs to be included as "administrative expenses." In fiscal years 1989 and 1991, however, the appropriations acts identified certain PBGC contractual and other expenses to be excluded from the administrative expense limitation, thus narrowing the activities and expenses subject to the administrative expense limitation. Over time, the percentage of PBGC's administrative expense limitation compared to the total operational and administrative budget has decreased dramatically, from 100 percent in fiscal year 1985 to 5.2 percent in fiscal year 2002. (See fig. 3 and app. III for more details.) This decrease resulted in part from the 1989 and 1991 statutory provisions that narrowed the activities under the administrative expense limitation. The decrease is also a result of PBGC's application of the statutory limitation in its budget process, which is described in a later section of this report.

Figure 3: Percentage of PBGC's Operational and Administrative Expenses Subject to Limitation, Fiscal Years 1985-2002



Source: PBGC data, GAO analysis.

[a]Total operational and administrative expenses for fiscal years 1987 and 1988 include $7.3 million in administrative expenses paid directly out of the trust fund. For fiscal years prior to 1989, "services related to terminations" expenses were paid directly out of the trust fund and were not included in revolving fund operational and administrative expenses.

The first limitation on PBGC's administrative expenses appeared in the Department of Labor Appropriations Act for fiscal year 1985. Expressing concern that PBGC had not informed Congress of prior-year commitments for computer acquisitions, the Senate Committee on Appropriations recommended to Congress that it cap PBGC's budget authority for its fiscal year 1985 "administrative expenses" at $33.1 million. This limitation applied to all of PBGC's operational and administrative expenses for fiscal year 1985, which covered PBGC's entire operational and administrative budget.[6] Congress has included a limitation on administrative expenses in each annual appropriations act since fiscal year 1985.

However, in subsequent years, Congress excluded expenses from the "administrative expenses" that had been included under the original limitation in fiscal year 1985. For fiscal year 1989, PBGC requested that Congress exclude certain contractual expenses from the administrative expense limitation. PBGC's Budget Director stated that the request was in response to several major plan terminations. He stated that PBGC needed flexibility to react quickly to the sizable cost and the unpredictable nature of pension plan terminations. The statutory administrative expense limitation in fiscal year 1989 limited PBGC's appropriations for "administrative expenses" to $44.2 million and allowed PBGC to exclude from the limitation its "contractual expenses" for

- legal and financial service contracts in connection with the termination of pension plans,
- asset management, and
- benefits administration services.[7]

[6]PBGC's Budget, Budget Justification, and supporting testimony are reflected in *Hearings on H.R. 6028/S.2836 Before the Subcomm. on Labor, Health and Human Servs., Educ. and Related Agencies of the Senate Comm. on Appropriations*, 98th Cong. 1083, Pt. 1 (1984), and in the pertinent committee reports accompanying the Department of Labor Appropriations Act for Fiscal Year 1985: H.R. Rep. 98-911, at p. 15 (1984); S. Rep. 98-544, at p. 18 (1984); H.R. Conf. Rep. 98-1132, at p. 9 (1984).

[7]Pub. L. 100-436, 102 Stat. 1680, Sept. 20, 1988.

In late fiscal year 1991, PBGC requested that Congress further expand its operational and administrative budget flexibility because of its rising workloads. PBGC requested that, for the last 2 months of fiscal year 1991 and thereafter, the exclusions from the expense limitation be expanded to include all expenses related to termination of pension plans, asset management, and benefits administration. Congress modified the administrative expense limitation as requested[8] and has excluded these expenses from the limitation in subsequent appropriations acts. Subsequent to fiscal year 1991, PBGC made changes in its approach to applying the statutory limitations, which resulted in a further reduction in the proportion of expenses falling under the limitation.

After we provided a draft of our report to PBGC, the President's proposed Budget of the United States Government, Fiscal Year 2004 was released on February 3, 2003. The fiscal year 2004 budget includes a proposal to eliminate the limit on PBGC's administrative expenditures.

PBGC's Application of the Statutory Limitation Is Not Reliable

During our review, we found significant problems with the way PBGC developed its budget estimates for its administrative expense limitation. As a result, PBGC's estimate for activities covered by the budget limitation is not meaningful or reliable. PBGC's Budget Director could not demonstrate that PBGC had conducted any analysis of expense classifications for PBGC's operational and administrative budget since PBGC last reviewed its activities in 1993. We identified flaws in the concepts supporting PBGC's budget estimates for expenses subject to the limitation. For example, PBGC did not identify any direct costs of activities falling under the expense limitation, and based its estimated budget only on the amount of indirect expenses not allocated to activities PBGC attributes to plan terminations. Based on this flawed concept, PBGC determined that its estimated budget for administrative expense limitation was $11.5 million for fiscal year 1995. PBGC has used that amount, with some minor adjustments, as a basis for all subsequent annual budget proposals, without subsequent validation.

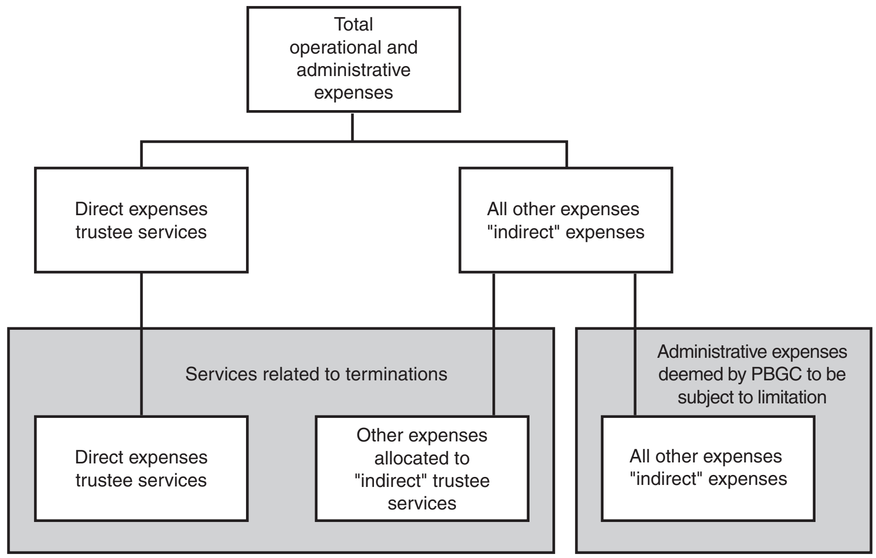
To calculate the estimated cost of activities subject to the statutory limitation based on the new exclusions that PBGC received beginning with the last 2 months of fiscal year 1991, PBGC's Budget Director told us that

[8]Pub. L. 101-517, 104 Stat. 2193, Nov. 5, 1990.

PBGC conducted reviews in 1991 and 1993 of activities at different organizational levels. The official told us that based on a 1993 review, PBGC identified and estimated direct and indirect expenses associated with PBGC's different activities, including premium collections and revolving fund investment services—the major expense activities deemed by PBGC to remain subject to the administrative expenses limitation. The PBGC Budget Director was unable to provide us with documentation supporting the review or the resulting expense allocations among PBGC's activities. The PBGC official also did not provide supporting documentation for the reasons why certain other regulatory and overhead activities were excluded from the budget estimates for the administrative expense limitation. Identifying and documenting its activities, along with a basis for including or excluding those activities from the administrative expense limitation, would have been PBGC's logical first step in developing a cost allocation methodology for identifying total expenses under the administrative expense limitation.

However, in its budget proposals for fiscal year 1995, PBGC used a flawed methodology for estimating costs that was inconsistent with the concept of assigning direct and indirect costs based on activities performed. Under its proposed operational and administrative budget, PBGC identified estimated direct expenses for "services related to terminations" that it considered trustee activities. PBGC then placed all other expenses in a pool it characterized as "indirect," even though these "indirect" expenses included direct expenses for premium collection and revolving fund investment services, the two major activities it deemed to be subject to the administrative expenses limitation. Further, PBGC estimated its budgeted amount for the expense limitation based on an allocation of the expenses in its pool of "indirect" expenses only. PBGC first allocated estimated "indirect" expenses to its "services related to terminations" based on the ratio of estimated direct expenses for trustee activities to PBGC's total estimated operational and administrative expenses. PBGC then assigned the remaining "indirect" expenses to the estimated budget for the limited administrative expenses, even though no direct expenses had been assigned to those activities, and even though, by definition, indirect expenses are generally not allocated to functions that do not have direct expenses. (See fig. 4.)

Figure 4: PBGC's Method of Calculating the Statutory Limitation on Administrative Expenses for the 1995 Budget Submission



Source: PBGC data, GAO analysis.

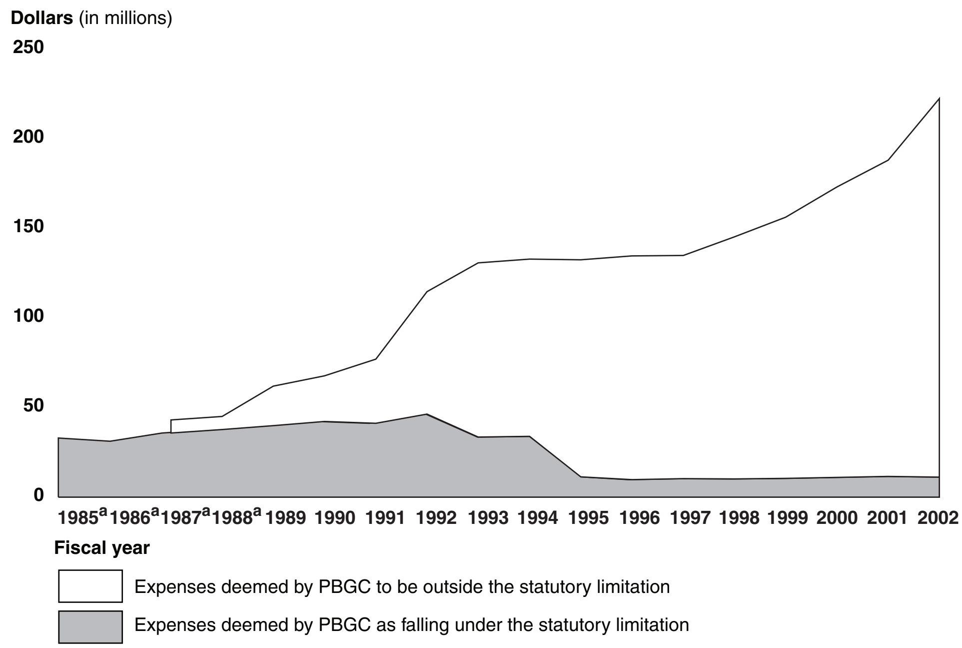
The effect of not considering the direct expenses associated with the activities falling under the limitation when budgeting for these activities is to arrive at a total budget estimate for limitation activities that may not be reasonable. The budget estimate could be overstated or understated depending on the actual level of direct expenses associated with limitation activities.

Based on this flawed approach, PBGC determined its proposed budget for the expense limitation to be $11.5 million in fiscal year 1995 and has used this amount as a basis for all subsequent years' budget proposals. According to PBGC's Budget Director, all of PBGC's subsequent budget proposals for the statutory limitation on administrative expenses have been based on the fiscal year 1995 budgeted amount of $11.5 million, with minor cost adjustments and inflation adjustments.[9] Therefore, from fiscal year

[9]PBGC's Budget Director told us that any differences between the proposed budget and appropriated amounts are due to rescissions. A rescission is legislation enacted by Congress that cancels the availability of budgetary resources previously provided by law before the authority would otherwise lapse.

1995 through 2002, the amount of budgeted expenses falling under the limited administrative expense category has generally remained constant, while PBGC's total budget for operational and administrative expenses has grown substantially. (See fig. 5.) PBGC has attributed all growth in expenses to trust fund activities and pays the increased expenses from the trust funds, without any verification of the validity of this approach.

Figure 5: Relationship of PBGC's Administrative Expense Limitation to Its Total Actual Operational and Administrative Expenses, Fiscal Years 1985-2002



Source: PBGC data, GAO analysis.

[a]Total operational and administrative expenses for fiscal years 1987 and 1988 include $7.3 million in administrative expenses paid directly out of the trust fund. For fiscal years prior to 1989, "services related to terminations" expenses were paid directly out of the trust fund and were not included in revolving fund operational and administrative expenses.

PBGC's Reporting of Expenses Falling under the Administrative Expense Limitation Is Not Meaningful

We found that PBGC does not account for the actual expenses within its administrative expense limitation. Instead, PBGC uses its budgeted amount as a basis for allocating and reporting actual costs for those activities. PBGC accounts for operational and administrative expenses for activities other than "services related to plan terminations" under the category, "administrative expenses." This amount includes indirect expenses for the statutory limitation category and indirect expenses for "services related to terminations." However, the amount prorated to the limitation is based on the initial amount of administrative expenses budgeted for activities PBGC subjects to the limitation and is designed to allocate to the limitation an amount equal or close to the originally estimated amount. This amounts to force fitting reported actual expenses so that they equal or come close to the statutory limitation amount. This method does not provide meaningful funds control over these activities. As a result, PBGC does not have a meaningful basis for reporting and tracking its compliance with the limitation. The reporting of actual expenses should be from detailed, transaction-based support for the direct and indirect expenses related to the activities subject to the limitation.

According to PBGC's Budget Director, PBGC developed its current method for reporting the costs associated with premium collection and revolving fund investment services to simplify the process and to avoid unduly complex and excessive accounting practices. He explained that the methodology was created to eliminate judgment calls and any "gray" distinctions between assigning costs for administrative activities subject to budget limitations and those not subject to budget limitations. This methodology, however, does not provide any reliable or meaningful cost data related to actual activities. Proper budgetary accounting provides a means to track the status of budget authority to help avoid overexpending or overobligating appropriations. A methodology for budgeting, allocating, and reporting costs should be clearly defined, well reasoned, consistently applied, and properly documented. However, PBGC's process for determining annual proposed and reported actual costs of activities subject to the statutory limitation on administrative expenses is neither reasonable nor reliable.

As discussed in our executive guide on best practices in financial management,[10] to effectively evaluate and improve the value derived from government programs and spending, Congress and other decision makers need accurate and reliable financial information on program cost and performance. We also note that financial information is meaningful when it is useful, relevant, timely, and reliable. Cost accounting principles call for direct costs to be assigned to an activity wherever feasible and economically practical, and indirect costs to be allocated on a reasonable and consistent basis. Such practices would require that PBGC periodically evaluate its methodology for assigning the direct costs of activities and the allocation of related indirect costs. Further, agencies administering appropriation and fund accounts are responsible for ensuring that the amounts obligated and expended do not exceed the legally imposed limitations. Thus, when obligating or expending amounts for its expenses under the administrative limitations, PBGC is required to separately track those amounts, including whether they were actually disbursed,[11] so that it can determine by expense category whether its obligations and expenditures are proper in amount and purpose.

Conclusions

PBGC's budget proposals for its administrative expense limitation, along with its reporting of the amounts spent under the expense limitation, are not based on actual data and thus are not meaningful or effective in controlling administrative costs. PBGC does not have a reliable basis for estimating its budget for activities subject to the legislative limitation. Even if PBGC had such a basis, it still would have no basis for reporting on adherence to the limitation, since it does not accumulate and allocate actual expenses for activities subject to the limitation. Its practice of reporting on limitation expenses so that the reported amounts are designed to equal or come close to the budgeted numbers further undermines the credibility of this process. Furthermore, the percentage of PBGC's operational and administrative budget subject to the limitation has fallen significantly while its total operations budget has increased significantly.

[10]U.S. General Accounting Office, *Executive Guide: Creating Value through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).

[11]OMB Circular No. A-11 (2002), §§ 20.4(b)(4), 82.14, and 86.6 require PBGC to separately account for and report limitations on its revolving fund authority in its budget proposals, apportionment or reapportionment requests (SF 132), and obligation and expenditure reports (SF 133).

Accordingly, the limitation as now structured and implemented does not represent a meaningful control over administrative expenses.

Matter for Congressional Consideration

With only about 5 percent of total operating and administrative costs falling under the limitation in fiscal year 2002, the statutory limitation on administrative expenses offers little opportunity for controlling operational and administrative expenses. Because the limitation no longer serves as a meaningful control over PBGC's administrative activities and expenses, Congress may wish to consider whether or to what extent to continue to use the administrative expense limitation as a tool for overseeing PBGC's activities. Congress could choose to more clearly define PBGC's administrative expense limitation, which would improve the limitation's use as an oversight tool during the normal congressional appropriations process. A more clearly defined expense limitation could result in a larger share of PBGC's expenses falling under the limitation. On the other hand, Congress may decide to eliminate the administrative expense limitation for PBGC altogether.

Recommendations for Executive Action

In order to provide cost information to assist Congress in its oversight of PBGC's expenses and for congressional decision making about whether or to what extent it should continue to use an expense limitation in its oversight of PBGC, we recommend that PBGC's Executive Director

- employ a systematic review, including both quantitative and qualitative measures, to develop a methodology for assigning the direct expenses related to its major categories of activities;
- develop a method of allocating indirect costs to each activity using a logical, reasonable, and consistent basis; and
- develop a method for accounting for actual direct and indirect expenses for its major activities.

Agency Comments

In commenting on a draft of this report, the Chief Management Officer (CMO) of PBGC noted that the Corporation had reached a conclusion similar to ours about the clarity of PBGC's current budget structure and stated that the budget structure must change. In this regard, PBGC's CMO stated that PBGC proposed a new budget structure for its fiscal year 2004 congressional budget submission that would restructure PBGC's budget program and financing activity line items so that they match up with PBGC's lines of business. PBGC's CMO further stated that PBGC will consider establishing an internal review process in which budget, finance, auditing, and legal staff will examine all budget lines midyear to ensure their correct classification to the new activities.

PBGC's CMO expressed concern that our report appears to be stating that PBGC's budget structure does not provide Congress with meaningful control. However, our report addresses the administrative expense limitation and not PBGC's overall budget. As we stated in our report, we found significant problems with the way PBGC developed its budget estimates for activities covered by the administrative expense limitation as well as with PBGC's reporting of actual expenses covered by the limitation. The percentage of PBGC's administrative expenses subject to the limitation has fallen significantly while its total operational and administrative expenses have increased significantly, resulting in only 5 percent falling under the administrative expense limitation. Accordingly, if Congress wishes to maintain some sort of limitation for some or all of PBGC's administrative expenses, the limitation as now structured and implemented does not represent a meaningful control.

PBGC's CMO disagreed with our conclusion that PBGC's reporting processes are not based on actual data. As we stated in our report, for reporting on administrative expenses that fall under the administrative expense limitation, PBGC uses its budgeted amount for the administrative expense limitation as a basis for allocating and reporting actual costs for those activities. As discussed in the body of our report, this PBGC process merely results in force fitting reported expenses so that they equal or come close to the budgeted amount for the statutory limitation, and accordingly, does not provide reliable cost data related to actual activities or a meaningful basis for reporting and tracking compliance with the limitation.

PBGC's CMO stated that the current budget proposal addresses the three recommendations in our report. However, as described in the CMO's response, PBGC's proposed budget restructuring does not specifically address our recommendations. As described in the CMO's response, PBGC's proposal does not address our recommendations calling for a systematic review to develop a methodology for assigning direct expenses to PBGC's major categories of activities, developing a method of allocating indirect costs to those activities, and developing a methodology for accounting for those expenses for its major lines of activities.

Finally, PBGC notes that it is facing historic challenges to the pension insurance system given the significant number of large plan terminations and other potential liabilities. We agree that this is an opportune time for Congress to decide whether or to what extent it will use the administrative expense limitation as an oversight tool. As we state in our report, Congress may wish to review whether to continue including such a limitation in appropriations acts as an oversight tool. If a statutory limitation for controlling costs continues to be desirable, Congress may wish to reexamine the scope of the limitation and require PBGC to apply and report on the limitation in a more meaningful manner.

As agreed with your office, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after its issuance date. At that time, we will send copies to the Chairman of the Senate Special Committee on Aging and to other interested congressional committees. We are also sending copies to the Executive Director of the Pension Benefit Guaranty Corporation. Copies of this report will also be made available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

Please contact me at (202) 512-9406 or by e-mail at franzelj@gao.gov if you or your staff has any questions concerning this report. Key contributors to this report were Darryl Chang, F. Abe Dymond, Meg Mills, and Estelle Tsay.

Sincerely yours,

Jeanette M. Franzel
Director, Financial Management and Assurance

Pension Plan Termination Procedures

The Employee Retirement Income Security Act of 1974 (ERISA) directs PBGC to oversee the termination of single-employer defined benefit pension plans under three different sets of circumstances.[1] Each type of termination involves different procedures. PBGC may be appointed as pension plan trustee under two of these procedures.

ERISA authorizes plan sponsors or plan administrators[2] to initiate the termination of ongoing plans under three general circumstances and through three corresponding procedures set out in federal regulations. First, a plan administrator may initiate a "standard termination" of a single-employer plan if the liabilities of the plan are sufficiently funded. "Standard termination" is the name given by ERISA to the termination procedure that consists primarily of a series of notices and valuations. Second, a plan administrator of a single-employer plan may initiate a "distress termination" when the plan sponsor and each member of the plan sponsor's controlled group meet financial distress criteria. "Distress termination" is the name given by ERISA to the termination procedure that authorizes plan administrators to notify PBGC that they intend to terminate a plan because (1) the employer is in liquidation proceedings, (2) the employer is in reorganization proceedings and the bankruptcy court determines that the employer is unable to continue in business if it must fund the plan, (3) PBGC agrees that the employer cannot pay all debts and cannot continue in business, or (4) PBGC agrees that the costs of continuing plan coverage are "unreasonably burdensome" solely because of a decline in the employer's workforce. If, during a "distress termination," PBGC determines that the plan is not sufficiently funded to cover the amounts it would guarantee, it *must* petition a federal district court or reach agreement with a plan administrator to terminate the plan.

[1]Employers in a multiemployer plan may terminate the plan through certain amendments or by withdrawing from it.

[2]Plan sponsors for multiemployer plans are either the plan's designated joint board of trustees or, if none, the plan administrator. Plan sponsors for single-employer plans are the employers responsible for contributing funds to the plan. Plan administrators are designated within the plan or, if none, are the plan sponsors or as otherwise designated by the Secretary of Labor.

A third termination procedure—"PBGC-initiated termination" (sometimes called "involuntary termination")—is available only to PBGC. PBGC *must* initiate the "involuntary termination" of a single-employer plan when it determines that there are insufficient plan assets to pay benefit liabilities currently due, and it *may* initiate a plan termination when, among similar reasons, PBGC's "long-run loss with respect to the plan may reasonably be expected to increase unreasonably."[3] "Involuntary termination" remains available during "standard" and "distress terminations."

Once the decision to terminate an underfunded plan has been made, either in a distress termination or in a PBGC-initiated termination, the applicable procedures vary:

- PBGC and the plan administrator may agree to the appointment of an interim trustee to administer the plan while they or a federal district court consider whether the plan should be terminated. If they do not agree to an appointment, either may petition a federal district court to appoint an interim trustee for that duration.[4]

- PBGC and the plan administrator may agree that the plan should be terminated, and if they also agree to the appointment of a permanent trustee, that trustee may terminate the plan.

- PBGC may apply to a federal district court for a decree adjudicating that the plan should be terminated, or if an interim trustee has been appointed, the trustee may also apply for that decree. The court must stay any proceedings against the plan in any court until it adjudicates the matter. If the court grants the decree, it authorizes the interim trustee to terminate the plan or appoints a new permanent trustee to do so.

- If an interim trustee is appointed upon initiation of the "involuntary termination," but the court dismisses an application for termination or PBGC fails to file an application within sufficient time, that trustee's duties end.

[3]29 U.S.C. § 1342 (a) (2000).

[4]According to PBGC officials, PBGC does not seek interim trustee appointments for policy reasons, and it has only been appointed as interim trustee once in the past 16 years.

A plan's termination date triggers various powers and duties of PBGC, employers, trustees, plan administrators and sponsors, participants, and the federal courts. The plan termination date generally is reached when agreed to by PBGC or when ordered by a federal court pursuant to the applicable termination procedure. On the plan termination date, benefits cease to accrue to plan participants, the plan is generally removed from coverage under Title I of ERISA, and the plan can be processed for liquidation.[5] The termination date is used by PBGC to make and issue determinations on the value of (1) vested benefits, (2) unfunded vested benefits, (3) employer liability for unfunded amounts,[6] and (4) PBGC's liability for its insured amounts.

Terminated plans under "PBGC-initiated terminations" are "closed-out" when PBGC issues final determinations of benefits payable to plan participants, resolves participants' appeals from the determinations, and places the plans in administrative status. Under the administrative status, PBGC contracts with plan administrators and other service contractors for subsequent investment of plan assets, payment of benefits due, and maintenance of participant data. The average age of benefit determinations issued in fiscal year 2002 was 3.3 years after the date PBGC was appointed as trustee. The average age of unissued benefit determinations at fiscal year end was 0.9 years.[7] Under "standard" and "distress terminations," plans are liquidated when PBGC receives a certificate of distribution of plan assets from a plan administrator (certifying that the administrator purchased annuities or paid participants a lump sum). Plan administrators do not manage benefit payments, participant data, or plan investments after they are distributed under "standard" or "distress terminations."

[5]United States v. Hook, 195 F.3d 299, 306-08 (7th Cir. 1999), *rehearing and rehearing en banc denied*, *cert. denied*, 529 U.S. 1082 (2000), *rehearing denied*, 530 U.S. 1226 (2000). 29 U.S.C. § 1307(a) (2000). Certain fiduciary duties under Title I continue, however. 29 U.S.C. § 1342(d)(3) (2000).

[6]In the case of bankruptcy liquidation or reorganization proceedings, PBGC values the plans' assets and liabilities (as modified by the bankruptcy court pursuant to its interpretation of bankruptcy law), and pursues a claim against the employer in those proceedings. Sometimes, the courts accept PBGC's valuation when prioritizing creditors' claims against the sponsoring employers' assets. PBGC may attempt to have its claims for employer liabilities designated as an "administrative expense," giving it a higher claims status. The relationships between ERISA and the bankruptcy and tax laws are often a cause for debate, and several statutory changes have been recommended or are pending in Congress.

[7]As reported in Pension Benefit Guaranty Corporation, *2002 Annual Report* (Washington, D.C.: 2002), 24.

PBGC estimates that it will approve 1,200 “standard terminations” and conduct 110 “involuntary terminations” by the end of fiscal year 2003 and anticipates the same workload in fiscal year 2004. ERISA also authorizes PBGC to restore any terminating or terminated plan to Title I “active” status, and it has done so with major plan failures, such as LTV Corporation’s $1.8 billion underfunded plans in 1986.

PBGC Finances Its Activities under Two Fund Types—Appropriated Revolving Funds and the Trust Fund

Prior to 1981, PBGC was treated as an off-budget federal entity,[1] and its transactions were excluded from the budget totals. Beginning in 1981, Public Law 96-364 required that PBGC's receipts and disbursements be included in the budget. These are accounted for in a single U.S. Treasury account and reported in a single budget account—the PBGC Fund, a public enterprise fund. PBGC also maintains separate trust fund accounts in a custodian bank for plan assets it holds as trustee and to account for terminating or terminated plans. These accounts are not included in the total of the federal budget. The trust funds, referred to by PBGC collectively as the "trust fund," reflect accounting activity associated with

- trusteed plans—plans for which PBGC has legal responsibility,
- plans pending trusteeship—terminated plans for which PBGC has not yet become legal trustee, and
- probable terminations—plans that PBGC determines are likely to terminate and be trusteed by PBGC.

To provide financing for PBGC, ERISA established revolving funds for PBGC that constitute permanent indefinite appropriations.[2] Out of these revolving funds, PBGC may pay its expenses, such as "operational and administrative expenses," guaranteed benefits, and financial assistance. Accordingly, PBGC categorizes its expenditures into three groups. (See fig. 6.) First are PBGC's "operational and administrative" expenses, which PBGC further divides into two subcategories: "administrative expenses" and "services related to terminations."[3] Both of these expense subcategories are paid from the revolving funds, but the trust fund periodically reimburses PBGC for the "services related to terminations"

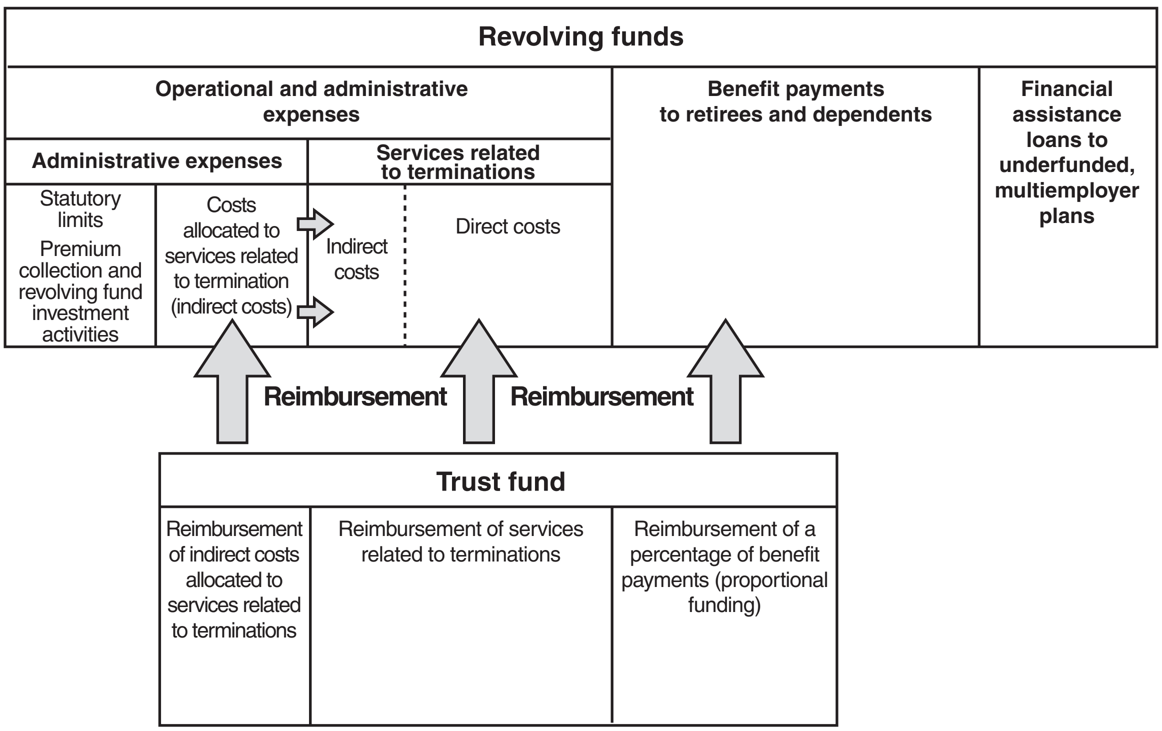
[1]Any federal fund or trust fund whose transactions are required by law to be excluded from the totals of the President's budget and Congress' budget resolutions, even though they are part of the total government transactions.

[2]29 U.S.C. § 1305 (2000); *Pension Benefit Guaranty Corporation's Use of Contingent Fee Arrangement with Outside Counsel*, B-223146 (Oct. 7, 1986). PBGC's revolving funds constitute permanent appropriations because they do not require subsequent congressional action to make their assets available for expenditure. They constitute indefinite appropriations because all receipts from ERISA's specified sources are available, the exact amount of which is determinable only at some future date.

[3]"Services related to terminations" expenses include expenses associated with terminating plans and other pretermination functions, as well as expenses related to administering terminated, trusteed plans.

expenses and portions of the "administrative expenses" that are allocated to "services related to terminations."

Figure 6: PBGC's Sources of Funding for Its Expenditures



Source: PBGC data, GAO analysis.

PBGC's two other expense categories are benefit payments that PBGC makes to retirees or their dependents (benefit payments) and financial assistance loans that provide PBGC assistance to underfunded multiemployer pension plans (financial assistance). PBGC expends its revolving funds for both categories, but the trust fund reimburses the revolving funds for a percentage of the amount of benefit payments. PBGC calculates the reimbursement percentage using what it calls its "proportional funding" method. The "proportional funding" percentage represents aggregate calculations of the amount of benefits that can be paid by the trust fund without its being depleted.[4] No financial assistance payments are reimbursed by the trust fund.

Appropriated Revolving Funds

Title IV of ERISA establishes seven revolving funds on the books of the U.S. Treasury and provided PBGC with permanent indefinite spending authority to carry out its duties. ERISA lists the programs, activities, and costs that each of the seven revolving funds may be used to support. Of the seven revolving funds, however, PBGC currently uses only three because it does not conduct the programs or activities supported by the other four. Of the three revolving funds that PBGC currently uses, funds 1 and 7 support the basic benefit guarantee program for single-employer pension plans and fund 2 supports the basic benefit guarantee program for multiemployer pension plans. All of these are combined into the PBGC fund for budget reporting purposes.

Title IV of ERISA lists the specific types of resources to be credited to each fund.[5] For example, PBGC's revolving funds 1 and 2 may receive premiums charged to employers, attorney's fees awarded to PBGC, earnings on investments of amounts in the funds, and amounts that PBGC may borrow from the U.S. Treasury (up to $100 million).[6] Revolving fund 1 may also receive amounts transferred to it from revolving fund 7. Revolving fund 7, however, may only receive certain premiums for single-employer plans, and

[4]The proportional funding ratio is determined by dividing the trust assets of the fund by the present value of future benefit payments of the fund.

[5]PBGC does not expend general tax revenues, and the United States is generally not liable for its obligations and liabilities.

[6]We are aware of only one instance in which PBGC exercised this authority. Immediately upon its creation in 1974, PBGC borrowed $100,000 to cover its start-up costs, and it repaid the loan shortly thereafter.

also the related penalties, interest charges, and earnings on investment of those amounts.

Title IV of ERISA also specifies the types of expenses that each fund may pay and certain types of expenses each may not pay. For example, PBGC may use the two benefit guarantee revolving funds to pay such costs as PBGC's guaranteed pension plan benefits, to purchase assets of terminated plans, and to pay for certain of PBGC's "operational and administrative expenses" not included in the statutory "administrative expense" limitation. However, PBGC may use amounts in each of its revolving funds only for the purposes specified by ERISA for each, and they may not be used to finance any other activity.

Congress reviews PBGC's budget each year, as required by the Government Corporation Control Act.[7] However, with the exception of amounts limited under the statutory limitation on administrative expenses, the revolving funds are available to PBGC without annual appropriations, so long as expenditures do not exceed available resources.

Trust Fund

Title IV of ERISA also authorizes PBGC to be appointed as interim trustee of pension plans to control them after it has initiated an involuntary termination (in its corporate capacity) or to serve as permanent trustee after the plan terminates. According to the PBGC General Counsel, "PBGC routinely requests that it be appointed trustee of terminated, under-funded pension plans, and courts routinely grant such requests."[8] PBGC administers such plans in the trust fund by depositing their assets into accounts held at a custodian bank. The trust fund identifies trusteed plan assets according to plan type (e.g., single employer) and year of termination. Once plan assets are deposited into the trust fund, PBGC combines them with the assets of similar plan types, so that the assets lose their individual plan accounting identity. Within the trust fund, however, PBGC currently accounts for more than trusteed plan assets, including (1) plans pending trusteeship—terminated plans for which PBGC has not become legal trustee by fiscal year-end—and (2) probable terminations—

[7]PBGC submits its annual budget program to OMB. The President, through OMB, submits PBGC's budget program to Congress together with his annual budget.

[8]Memorandum of Law In Support of Pension Benefit Guaranty Corporation's Motion to Dismiss, Pineiro v. Pen. Ben. Guar. Corp., No. 96 CIV 7392 (LAP), filed Jan. 31, 1997 (S.D. N.Y. 1997).

plans that PBGC determines are likely to terminate and be trusteed by PBGC. PBGC expends amounts from these combined accounts for plan benefit payments and expenses arising from all the plans.

PBGC distinguishes the legal status of its revolving funds from its trust fund, concluding that the "private" trust fund assets are not subject to government restrictions on their use, except to the extent that PBGC voluntarily abides by any restrictions. In 1985 and 1986, we concluded that the funds held by PBGC as permanent trustee of terminated plans under ERISA were not subject to the laws applicable to expenditures of appropriated funds by wholly owned government corporations. Specifically, we concluded that they were not subject to laws related to procurement of investment manager services, laws requiring the deposit of collections into the General Fund of the U.S. Treasury, and laws requiring the use of government printing plants.[9]

We found that when PBGC assumed the fiduciary duties of permanent trustee as prescribed by ERISA, the specific activities considered in those cases were "fundamentally different" than those arising from its governmental duties because the outcome would inure to "the benefit of the trust funds and not to the direct benefit of the United States." Because these fiduciary duties were the same as those of a "private fiduciary" appointed to the same position, we concluded that the funds should be treated as "non-public" in nature for the purposes of the specific activities then under review.[10] Since then, a 1987 amendment to ERISA expanded PBGC's authority to pool the assets of any terminated plan for administration, investment, payment of the liabilities of those pooled plans, and for other purposes that PBGC deems appropriate.[11]

[9]*Procurement of Investment Manager Services by the Pension Benefit Guaranty Corporation*, B-217281-O.M. (Mar. 27, 1985); *Matter of Pension Benefit Guaranty Corporation's Use of Contingent Fee Arrangement with Outside Counsel*, B-223146 (Oct. 7, 1986); *Matter of Pension Benefit Guaranty Corporation Printing and Distribution Requirements*, B-217628, 65 Comp. Gen. 226, nt. 1 (Jan. 23, 1986); see also *Fiduciary Duties of Pension Benefit Guaranty Corporation*, B-284479 (Jan. 27, 2000).

[10]Our decision in *Matter of Pension Benefit Guaranty Corporation's Use of Contingent Fee Arrangement with Outside Counsel*, B-223146 (Oct. 7, 1986), stated the proposition that moneys sought, received, and managed by PBGC as an ERISA trustee constitute "private" assets because they would benefit only plan participants under ERISA's trust provisions. In that case, the money sought under an otherwise improper contract arrangement "primarily consist[ed] of" employer liabilities that, beginning that year, were to be deposited in a special ERISA trust fund for that purpose.

PBGC now administers the trust fund together with the revolving funds under a "proportional funding" method whereby it pays benefits from each of these funds using financial calculations designed to maximize the longevity of their combined assets. PBGC uses the trust fund for all of its corporate expenses except those subject to the statutory limitation on administrative expenses, the benefit payment amounts "proportionately" attributed to the revolving funds, and the amounts for multiemployer plan financial assistance.

According to PBGC budget and accounting officials, the assets and liabilities of trusteed terminated plans, terminated plans pending trusteeship, and "probable terminations" are accounted for by program and year within the trust fund. PBGC uses the value of its accounts in its allocation of investment gains and losses and in its expenses. It allocates earnings and expenses to individual trust funds in proportion to their value relative to the total amount of the trust funds, unless such activities are directly attributable to a specific fund. PBGC's trust funds are not included in the federal budget.

Reimbursement of Appropriated Revolving Funds from the Trust Fund

In the fiscal years from 1985 through 1988, expenses for the administration of terminated plans entrusted to PBGC were accounted for under the separate trust fund, which is not subject to the appropriations act limitation on administrative expenses. Consequently, amounts budgeted for these trust fund expenditures were not included in PBGC's revolving fund budget submitted to Congress. For example, in fiscal years 1987 and 1988, the trust fund directly paid $7.3 million for administrative expenses for trust fund operations that were not included in the revolving fund operating budgets. During fiscal year 1989, as PBGC needed additional amounts in the revolving funds for additional unbudgeted contractual expenses, it used additional funds from its trust fund without a need for further congressional approval.

[11]Pub. L. 100-203, §9314, 101 Stat. 1330-366, Dec. 22, 1987 (29 U.S.C. § 1342 (a) (2000).

For its fiscal year 1989 budget, PBGC included in its budget submission to Congress a request for authority to initially use the revolving funds for all revolving fund and trust fund expenses, with the trust fund later reimbursing the revolving funds for trustee-related expenses associated with plan terminations. In the committee reports accompanying their respective appropriations bills, the House and Senate Appropriations committees approved the PBGC proposal to pay expenses from the revolving funds, without limitation, that were previously paid from the trust fund.[12]

PBGC now routinely makes payments from the revolving funds first, with reimbursements from the trust fund.[13] For example, in fiscal year 2001, PBGC's total reported operational and administrative expenses of $187.9 million included amounts chargeable to both the revolving funds and the trust fund. Of this, PBGC charged $176.3 million to the trust fund. Because not all of these were actually paid out during fiscal year 2001, PBGC carried forward to fiscal year 2002 those amounts due to the revolving funds, totaling about $173.3 million.[14] The remaining amount of about $11.6 million was not reimbursed, and was therefore paid by the revolving funds, and it reflects slightly less than the estimated $11.7 million for administrative expenses limited by Congress for fiscal year 2001. PBGC has stated that only the amounts submitted to Congress in its administrative expense budget are subject to the annual appropriations review process because the remaining amounts are reimbursed from the trust fund and constitute "non-public" funds.[15]

[12]S. Rep. 100-399, at 20 (1988); H.R. Rep. 100-689, at 17 (1988).

[13]PBGC officials stated that "the language establishing the uses of the revolving fund (See ERISA Section 4005) and the language governing the uses of the trust fund (See ERISA Section 4042) allow virtually any corporate expenditure to be paid for out of either [the revolving or the trust] fund." PBGC also stated that alternative practices would be administratively unfeasible and very costly.

[14]The total adjusted reimbursable amount from the trust fund was $178 million. See *Budget of the United States Government, Fiscal Year 2003—Appendix*, 667. The amount actually reimbursed during fiscal year 2001 includes amounts disbursed from the revolving funds during that year plus amounts carried forward from fiscal year 2000.

[15]The Subcommittee on Labor, Health and Human Services, and Related Agencies of the House Committee on Appropriations published the same conclusion in its committee report after its 1998 budget hearings where it questioned PBGC management on this issue. H. Rpt. 105-205 (1997).

Limitation on Administrative Expenses Compared to Total Operational and Administrative Expenses, FY 1985-2003

Dollars in millions

Fiscal year	Statutory administrative limitation	Total budgeted operational and administrative expenses	Actual expenses for administrative limitation	Total actual operational and administrative expenses	Percentage of limitation to total operational and administrative expenses
1985	$33.1	$33.1	$33.0	$33.0 [a]	100.0
1986	32.3	32.3	31.2	31.2 [a]	100.0
1987	36.9	36.9	35.8	43.1[a]	83.1
1988	40.4	40.4	37.7	45.0[a]	83.8
1989	44.2	73.3	39.9	61.9	64.5
1990	42.3	70.4	42.2	67.7	62.3
1991	42.7	71.1	41.2	76.9	53.6
1992	46.8	103.4	46.3	114.6	40.4
1993	33.9	131.1	33.5	130.7	25.6
1994	34.2	135.7	33.9	132.8	25.5
1995	11.5	137.5	11.3	132.4	8.5
1996	10.6	141.2	9.8	134.6	7.3
1997	10.3	135.7	10.3	134.8	7.6
1998	10.4	147.8	10.2	145.2	7.0
1999	11.0	159.9	10.5	156.1	6.7
2000	11.1	174.7	11.0	173.0	6.4
2001	11.7	190.6	11.6	187.9	6.2
2002	11.7	227.2	11.6	225.2	5.2
2003	13.1[b]	225.4[b]	Not available	Not available	Not available

Source: PBGC data.

[a]Total operational and administrative expenses for fiscal years 1987 and 1988 include $7.3 million in administrative expenses paid directly out of the trust fund. For fiscal years prior to 1989, "services related to terminations" expenses were paid directly out of the trust fund and were not included in revolving fund operational and administrative expenses.

[b]Proposed in President's Budget.

Comments from the Pension Benefit Guaranty Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

PBGC
U.S. GOVERNMENT AGENCY
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

FEB 6 2003

Ms. Jeannette M. Franzel
Director, Financial Management and Assurance
General Accounting Office

Dear Ms. Franzel:

Thank you for the opportunity to review your draft report on the Corporation's administrative expense limitation. We appreciate the effort of your staff in working on this complex, technical issue regarding the Congressional limitation on a portion of PBGC's budget.

While the report reaches a similar conclusion to one that we have reached about the practicability and clarity of the current structure, we are concerned about the implication throughout the report that PBGC's budget does not provide Congress with meaningful control. In addition, we disagree regarding the conclusion that our reporting processes are not based on actual data. Specifically, the obligations reported under the administrative expense limitation are based on actual data, and finally determined through our allocation process. Overall PBGC has a system for accumulating and reporting actual obligations consistent with its approved SF 132 Apportionment/Reapportionment Schedule.

We agree that the structure must change, and have worked with the Office of Management and Budget to develop a new budget structure, which you will find presented in PBGC's FY 2004 Congressional budget submission. However, we believe that our past budget practices provided an opportunity for Congress to have appropriate oversight of our budget process.

See comment 1.

The report's conclusion about the amount of control over PBGC's "administrative" costs seems to have resulted at least in part from confusion over the terms used and the practices applied. The report speaks of "operational and administrative" expenses, and of expenses in PBGC's role as trustee[1], but neither

[1] In a number of places, the Report talks about expenditures related to PBGC's responsibilities as "trustee." In doing so, the Report seems to imply that only expenditures as trustee may be considered "nonlimitation" expenses. That is simply not the case. As noted above, Congress classifies as "nonlimitation expenses" all expenses in connection with the termination of pension plans, for the acquisition, protection or management, and investment of trust assets, and for benefit administration services. The PBGC budget structure classifies all such

phrase appears in PBGC's annual authorization. Instead, the Corporation's annual authorization sets a dollar amount of moneys PBGC can expend from its revolving funds (the so-called "limitation" expenditures) and then provides, "[T]hat expenses . . . in connection with the termination of pension plans, for the acquisition, protection or management, and investment of trust assets, and for benefits administration services shall be . . . excluded from the . . . limitation." In other words, "administrative expenses" do not necessarily mean just administrative costs; in fact, they cover anything not related to trust expenses or benefits administration, including such "line" costs as premium collections.

Even at the time Congress adopted this language, PBGC officials recognized that the exceptions (to the limitation) had virtually swallowed the rule; i.e., the vast majority of PBGC expenditures resulted from the termination of pension plans, the investment of trust assets, or benefits administration. They also knew, however, that the language had to be read in conjunction with the dollar limitation. Accordingly, they initially divided Corporation expenses between two expense categories:

1) expenditures directly related to one of the three enumerated categories of expenses (termination of pension plans; protection, management and investment of trust assets; and benefits administration) which were funded 100% with non-limitation, trust fund moneys; and

2) other expenditures, e.g., expenses for internal operations such as those of the Facilities and Services Department and the Human Resources Department, and such line operations as premium collections, which did not directly relate to termination of pension plans; protection, management and investment of trust assets; etc.

By 1993, however, the Corporation realized that this dichotomy of expenditures led to problems. It seemed too facile to assume that all of the Corporation's internal operating expenses, for example, had no accounting relationship to the termination of pension plans and other activities funded from the non-limitation

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expenses, including those related to termination of pension plans as nonlimitation. Many termination activities are performed not as trustee, but as part of PBGC's other statutory responsibilities, and would have to be performed regardless of whether PBGC were statutory trustee. For example, the Report suggests that benefit calculations and certain benefit payments are trustee responsibilities. As PBGC has argued in ongoing litigation, these are not statutory trustee responsibilities, and would be performed by PBGC even if a third party had been appointed trustee. Nevertheless, the costs of performing such benefit calculations and making benefit payments are properly characterized as nonlimitation expenses – they fit within the subcatagory of benefit administration services – and as such, those costs are properly charged to the trust funds.

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budget. Clearly, the Corporation's infrastructure expenditures in support of these activities should have been charged to the nonlimitation, trust fund expenditures. As a result, the Corporation established "allocated nonlimitation" funds for this purpose; this allocation of indirect expenditures along with direct expenditures more accurately reflected PBGC's actual requirements and expenses. While the current draft report expresses a certain concern about the Corporation's budget structure, GAO was provided a comprehensive briefing by PBGC's budget director regarding the current methodology when it was being developed and implemented during the mid-1990's. No basic concerns were raised at that time and we believed that this practice was an acceptable and reasonable approach.

See comment 2.

Each year there is a detailed line item review made of every one of the hundreds of budget line items in PBGC's operating budget system to ensure appropriateness of which budget activity to charge, as well as the reasonableness of the charge itself. This detailed review is performed by the Budget Department and to some extent, the Corporation's Budget Planning Integration Team (BPIT). Also, the Budget Department holds periodic meetings, throughout the year, with PBGC departments to ensure they are spending in accordance with their budget plan.

Over the years, PBGC has regularly reviewed its expenditures to ensure the appropriateness of these allocations. With the growing number of pension plan terminations involving large numbers of participants, the percentage of infrastructure expenditures directly related to terminations, investment and benefit administration grew substantially and the percentage of infrastructure expenditures related to other Corporate activities declined. This is because PBGC's other line of business, Pension Insurance (basically premium operations) has been relatively stable.

The "nonlimitation" part of PBGC's budget, as the report points out, grew to account for an increasing portion of the Corporation's budget. This did not reflect an attempt to evade the constraints of the limitation budget. Instead, the shift in percentages occurred as a natural result of PBGC's non-limitation expenses growing so much faster than the limitation budget expenses. That occurred because of the large numbers of plan terminations and the concomitant large increase in benefit administration activity, and trust asset protection, management and investment activity.

See comment 3.

The report states that PBGC did not fully document the ongoing analyses of its limitation and allocated nonlimitation. We would contend that our documentation, whatever its apparent deficiencies, was proportionate to amounts at stake compared to the pressing nature of other concerns – such as obtaining the funding necessary to fulfill our statutory obligations. Any analysis of our budget process has to take into account the real world we found ourselves in. In 1985, the Corporation had responsibility for a total of 171,000 current and future payees in some 1,300 plans. By the end of FY 2002, this had grown to 783,000 participants in over 3,100 plans. Just in the last three years, PBGC has become responsible for the plans of TWA, Grand Union, LTV Steel, and, most recently, Bethlehem and National Steel Corporations.

Despite this growth in workload, and the growth in PBGC's overall budget, the administrative expenses limitation remained fairly constant. Between 1995 and 2000, for example, PBGC's overall operational budget rose from $133.7 million to $187.8 million, but the administrative limitation -- subject to rescissions and other constraints -- actually fell, from $11.5 million to $11.1 million. Of course, the "allocated nonlimitation" or indirect portion of our budget rose; it rose because more termination work meant more work in information technology, procurement, human resources, and most other areas of administration. It also rose because we developed new accounting systems and implemented other financial controls that enable PBGC to earn and maintain clean audit opinions. Equally important, it ensures that the Corporation properly collect monies owed it.

We consider it critically important to remember that, whatever problems it may have presented in administration, the budget limitation did in fact provide Congress with a means of reviewing PBGC's annual budget submission every year since its implementation. Each year since 1985 the Corporation has presented all of its annual costs to Congress, rather than just a portion narrowly defined as "administrative." Each year Congress has reviewed and approved that budget, as has the Office of Management and Budget. Congressional hearing records will show that our full budget was being reviewed, not just the limitation amount. PBGC has also continued to review its internal budget by each year examining each of the hundreds of project lines in its budget to ensure their correct alignment with the activities of "administrative expenses" and "services related to terminations."

We also note that under the Government Corporation Control Act (the "GCCA"), 31 U.S.C. section 9101 et seq., PBGC is required to " ... prepare and submit each year to the President, a business-type budget in a way ... the President prescribes ...." The PBGC complies with this mandate.

Regarding the report's recommendations, we believe it important to note that in enacting the Government Corporation Control Act (GCCA), Congress did not intend to subject Government Corporations to the budgetary controls applied to Government agencies. The GCCA was enacted "to bring Government corporations and their transactions and operations under annual scrutiny by the Congress and to provide current financial control thereof." Control Act, section 2, 59 Stat. 597. A "Resume in Explanation of H.R. 3660" accompanied the bill to the House floor. The resume contains the following acknowledgment:

> *[Government] corporations were created to conduct their activities with a freedom thought to be inconsistent with the types of financial control applicable to the regular Government departments and agencies.*

93 Cong. Rec. H8546-8547 (daily ed. Sept. 12, 1945) (statement of Rep. Sabath) (emphasis added).

Notwithstanding the above discussion, we agree that the current budget structure and methodology can be confusing and needs improvement. As mentioned above, we have developed a proposed new structure for our FY 2004 Congressional budget submission. In brief, the new structure would restructure PBGC's Budget Program and Financing activity line items so that they match up with the Corporation's lines of business. This results in the following budget activity structure:

> <u>Pension Insurance</u>: Includes pension plan technical assistance, new pension plan promotion activities, premium collections and premium investments.
>
> <u>Pension Plan Termination</u>: Includes all activities related to plan termination and trusteeship, plan asset management investment and accounting, and benefit administration.
>
> <u>Operational Support</u>: Includes the administrative, information technology infrastructure and other direct program support for both the Corporation's insurance and plan termination lines of business. This activity is clearly linked to the Corporation's success in carrying out its two program lines of business.

The current budget already receives 95% of its funds from the trust funds and, as discussed in the report and elsewhere in this letter, the current methodology of trying to pay for operational costs from both premiums and trust funds overly complicates PBGC's budget administration. Eliminating this requirement allows for significant simplification and better understandability of PBGC's operational budget. Under the proposed budget structure, all expenses would continue to flow through PBGC's Revolving Fund and then be reimbursed by the trust funds to cover PBGC's full operating budget (excluding benefit payments and financial assistance).

To strengthen PBGC's accountability to the Congress, this proposal suggests that PBGC continue to submit its entire budget justification for annual review by the appropriation committees. The new language would still permit PBGC to request a reapportionment if unexpected program workload later required an increase in operational funding. But unlike today, the Corporation would provide a 15-day notification of a reapportionment increase for operational expenses to the appropriation committees before PBGC could obligate any of the funds. Department of Labor and Office of Management and Budget oversight would continue as at present.

We believe that our current budget proposal sufficiently addresses the three recommendations contained in the report. Further, PBGC will consider establishing an internal review process, in which a board of financial, budget, legal, and audit staff will conduct a mid-year examination of all budget lines to ensure their correct classification to the new activities. This board will document the rationale for any changes and establish a more formal record than under the current system.

At the current time, we are facing historic challenges to the pension insurance system given the significant number of large plan terminations and other potential liabilities. In order to meet these challenges, PBGC needs the flexibility that our proposed budget proposal would provide to help us fulfill our mission. I would hope that, when issued in final, your report will take into account the above discussion and reflect a balanced view of PBGC's overall level of budgetary responsibility, and the very real operational challenges the Corporation has faced since the implementation of the administrative expense limitation in 1985.[2] Again, I appreciate the opportunity to comment on the draft report.

Sincerely,

John Seal
Chief Management Officer

[2] In addition to this response, PBGC has provided under separate cover a number of suggested technical corrections to the draft report.

The following are GAO's comments on the Pension Benefit Guaranty Corporation's (PBGC) letter dated February 6, 2003.

GAO Comments

1. The term "administrative expenses" in appropriations acts, legislative history, and PBGC's practices differ from how the term is typically used. Therefore, we used terminology in our report that we believe is understandable to third parties not involved in PBGC's annual appropriations process. Throughout the report, we are specific when we discuss the expenses that fall under PBGC's limitation, and use the term "administrative expenses that fall under the limitation" or the "administrative expense limitation."

2. As we state in our report, the reviews conducted by PBGC in 1991 and 1993 to identify and document its activities would have been PBGC's logical first step in developing a cost allocation methodology for identifying total expenses under the administrative expense limitation. However, in its budget proposal for fiscal year 1995, PBGC used a flawed methodology for estimating costs that was inconsistent with the concept of assigning direct and indirect costs based on activities performed. Furthermore, PBGC has not reviewed this methodology since then.

3. We do not disagree with PBGC's overall assumptions about the relationship of its costs to its overall workload trends. However, PBGC has not reviewed its activities—looking at approach and amounts—to determine whether the large changes in the scope of its workload call for changes in the way it budgets and reports the amounts subject to the administrative expense limitation.

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